HOW FRAGILE IS RUSSIA? A 14-PAGE SPECIAL REPORT

The Economist

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Obama's new team

Boosting the world economy

A final chapter in Iraq?

Internet advertising, still clicking

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Politics this week

Nov 27th 2008
From The Economist print edition

AFP



In co-ordinated attacks in **Mumbai**, India's business capital, terrorists armed with machineguns and grenades killed scores of civilians and took a number of hostages. Luxury hotels and other sites favoured by Westerners were singled out for attack. See article

Anti-government protesters in **Thailand** occupied Bangkok's main airport, stranding thousands of passengers. Amid mounting street violence, the army chief, General Anupong Paochinda, urged the government to call fresh elections, and the protesters to go home. Neither side heeded his call and the protesters forced the closure of a second airport that services domestic flights. See article

The Election Commission in **Bangladesh** postponed the country's general election from December 18th to the 29th. The Bangladesh Nationalist Party signalled its willingness to take part in the polls, along with the other main party, the Awami League.

China announced that it would not attend a scheduled summit with the European Union**,** less than a week before it was due to take place in Lyon. This was seen as a snub to France's president, Nicolas Sarkozy, who has said he intends to meet the Dalai Lama in December. See article

A meeting of **Tibetan exiles** in Dharamsala, the northern Indian seat of the Dalai Lama, closed with a strong endorsement of his policy of seeking a "middle way" of autonomy for Tibet within China. However, some exiles said they might seek full independence if the fruits of engaging China are not evident soon.

Very stimulating

Barack Obama proposed a new **stimulus** package, which includes an infrastructure programme that creates or retains jobs for 2.5m people. It is a much bigger plan than anything the candidate mentioned on the campaign trail. America's president-elect wants Congress to write the legislation now so that he can sign it after taking office.

Meanwhile, the **European Union** urged its member states to spend some €200 billion ($260 billion) to stimulate their economies. Some, including Britain and France, took separate measures. Alistair Darling, Britain's chancellor, cut the restraints on public borrowing; **Britain's** net debt is to surge from 36% to 57% of GDP by 2013-14. See article

Mr Obama named his economic team. He nominated **Timothy Geithner**, the president of the Federal Reserve Bank of New York, as his treasury secretary, and chose **Lawrence Summers**, a former treasury secretary under Bill Clinton, to head the National Economic Council. Mr Obama also established a new Economic Recovery Advisory Board to be led by **Paul Volcker**, who chaired the Federal Reserve between 1979 and 1987. See article

The Pentagon decided to transfer Osama bin Laden's former driver, Salim Hamdan, from **Guantánamo** to Yemen, enabling him to end his sentence (on December 27th) in his homeland. Mr Hamdan's case went to the Supreme Court as a test case about the status of Guantánamo. A military commission eventually convicted him of providing material support to terrorists.

Seeking some kind of closure

Iraq's fractious parliament debated whether to endorse an agreement with the United States that would require American troops to withdraw from Iraq's cities by the middle of next year and altogether from Iraq by the end of 2011. See article

Mahmoud Abbas, the president of the **Palestinian Authority**, said that if planned talks between his Fatah group and the rival Palestinian Islamist movement, Hamas, failed again, he would call in January for presidential and legislative elections to be held, probably in April.

Zimbabwe's president, Robert Mugabe, barred three leaders of a peacemaking group known as "the Elders" from entering his country to assess its situation. The three are a former American president, Jimmy Carter; a former secretary-general of the UN, Kofi Annan; and the Mozambican wife of South Africa's Nelson Mandela, Graça Machel.

Congo's government rejected the advice of the UN mediator, Olusegun Obasanjo, Nigeria's former president, to talk directly to the rebel leader of the Congolese Tutsi minority, Laurent Nkunda, except under the terms of an agreement signed earlier this year which General Nkunda repudiated.

A mediator said that Joseph Kony, leader of **Uganda's** murderous Lord's Resistance Army, was again set to sign a peace deal with Uganda's government. Mr Kony is wanted by the International Criminal Court at The Hague.

Everyone's a winner

Venezuela's president, Hugo Chávez, and his opposition both claimed victory in an election for state and municipal governments. Mr Chávez's supporters won in 17 out of 22 states, but the opposition won Caracas, the capital, and the three most populous states. See article

Three Russian warships arrived in Venezuela for joint naval exercises. **Russia's** president, Dmitry Medvedev, visited Venezuela and Brazil as part of a four-country Latin American tour aimed at increasing trade and his country's presence in the region. See article

AP

In **Brazil**, floods and mudslides in the southern state of Santa Catarina killed at least 97 people, made 50,000 homeless and cut off several towns.

Reversing its previous stance, **Canada's** government said it would support a cap-and-trade system to limit emissions, matching a commitment made by Barack Obama.

Royal rumble

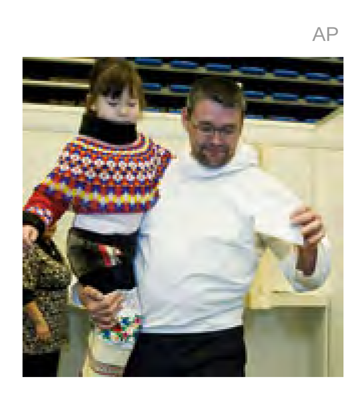
Martine Aubry was chosen as leader of the **French Socialist Party**. But her margin of victory over Ségolène Royal, the defeated presidential candidate in 2007, was minuscule. Ms Royal has made clear that she will still seek the presidential nomination in 2012. See article

The mayor of Vladikavkaz, capital of **North Ossetia**, a province in the Russian Caucasus, was assassinated by gunmen.

The Czech constitutional court ruled that the European Union's **Lisbon treaty** was acceptable. Both the Czech Republic and Poland are ready to ratify the treaty, leaving Ireland, whose voters rejected it in June, as the only holdout.

Greenland's voters approved a set of changes to give themselves more autonomy from Denmark. Observers reckon this could be a step towards full independence. See article

AP



Business this week

Nov 27th 2008
From The Economist print edition

America's Federal Reserve and Treasury Department announced that they would make $800 billion available to distressed credit markets in the **latest effort to revive the financial system**. A new $200 billion facility will extend loans to holders of highly rated securities related to consumer-debt. The Fed will use up to $500 billion to buy mortgage-backed securities guaranteed by government-sponsored enterprises (including Fannie Mae and Freddie Mac) and another $100 billion to buy GSE debt. This brought about an immediate, sharp fall in mortgage rates and helped underpin a stockmarket rally. See article

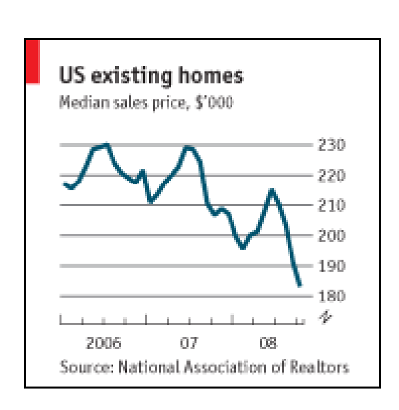
Share prices also rose in response to **Citigroup's** bail-out by the American government. After the recent collapse of the giant bank's share price, federal officials offered to back $306 billion of Citi's toxic assets, mostly connected to property loans. Timothy Geithner, Barack Obama's choice as treasury secretary, was involved in an important stage of the rescue negotiations in his current role as president of the Federal Reserve Bank of New York. See article

The new reality

Investors reacted positively to an initial sale of **Goldman Sachs bonds**, the first big such offering under the government's Temporary Liquidity Guarantee Programme set up in October. The bonds are similar to Treasuries in that they are backed by the government, though the yields are higher on Goldman's bonds, which mature in three-and-a-half years. Other companies, including Morgan Stanley, are set to take advantage of the scheme to boost capital.

AIG said it would freeze the pay of its seven most senior executives, and that its chief executive would receive a token salary of $1. The decision was welcomed by those who had criticised the insurance company when executives lavished $440,000 at a resort soon after AIG was bailed out. Separately, Marcel Ospel, a former chairman of **UBS**, who was ousted in April, agreed to return SFr22m ($18.4m) in pay to the troubled Swiss bank.

Data from the National Association of Realtors indicated that America's **housing market** may have some way to go before it bounces back. Sales of existing homes fell again in October after rising slightly in September. The median price for such homes plunged by 11.3% from a year earlier, the largest decline ever in the NAR's survey, to $183,300.



China's central bank reduced interest rates for the fourth time since mid-September. The benchmark rate for one-year loans was slashed by 1.08 percentage points, to 5.58%, the largest single cut in the rate since October 1997.

Gulf storm

Saudi Arabia's central bank lowered its key interest rate for the second time in a month and loosened reserve levels at commercial banks in an effort to encourage lending and boost liquidity. The kingdom's main stockmarket index has fallen by about 60% since the start of the year, and **oil prices** have declined swiftly from their peak of more than $147 a barrel in mid-July to around $50 now.

Woolworths and **MFI**, two of Britain's best-known retailers, went into administration. Woolworths (separated in 1982 from its then American parent company) has been a fixture on Britain's high street since the opening of Franklin Winfield Woolworth's first British store, in Liverpool, in 1909.

Hewlett-Packard reported solid quarterly earnings, thanks partly to a surge in sales of its laptop computers and the acquisition of EDS, a technology-services provider, earlier this year.

No Rio carnival

BHP Billiton pulled its offer for **Rio Tinto**, citing the steep drop in commodity prices in recent weeks and a worsening outlook for the global economy. A merger would have created a mining behemoth. The all-stock deal was valued at about $140 billion when it was first made public by BHP Billiton a year ago; Rio Tinto always insisted the bid was too low. Since then the share prices of both companies have tumbled, and the deal was worth around $66 billion when it was abandoned. See article

A long-running dispute between two Russian oligarchs fighting for control of **Norilsk Nickel** was put on hold. Citing the credit crunch, Vladimir Potanin and Oleg Deripaska agreed not to stand for election to the board of the world's biggest nickel producer. But with a state representative set to join Norilsk's 13-person board, observers noted that the Kremlin was strengthening its hand in the company.

A former board member of **Siemens** was given a two-year suspended sentence and fined for authorising illegal payments to the smaller, and more friendly, union at the company. It is the first sentence to result from a string of corruption scandals that have engulfed the German engineering giant.

KAL's cartoon

Nov 27th 2008
From The Economist print edition

Illustration by KAL



The Mumbai attacks

Terror in India

Nov 27th 2008
From The Economist print edition

A dangerous new front-line in the global war against terrorism



TERROR has stalked Mumbai, India's commercial capital, all too many times before. In 1993 more than 250 people died in a series of bomb attacks, seen as reprisals for the demolition by Hindu fanatics of the mosque at Ayodhya. In 2003, more than 50 people were killed by two car bombs, including one just outside the Taj Mahal hotel, next to the monumental tourist attraction, the "Gateway of India". And in 2006 over 180 people were killed in seven separate explosions at railway stations and on commuter trains. But the latest atrocity—or rather co-ordinated series of atrocities (see article)—is something new to the city. It has alarming implications not just for India, but for the entire international fight against terrorism.

It differs from most previous attacks in two important ways: in the sophistication of the operation's planning and the terrorist manpower that must have been involved; and in selecting foreigners as targets: hostage-takers seem to have sought out American, British and Israeli victims. As *The Economist* went to press, the crisis in Mumbai was still unfolding. Hostages were still held, fires still smouldering at the Taj Mahal hotel and occasional gunfire and explosions still to be heard. It was uncertain who was responsible, though a previously unknown group calling itself the Deccan Mujahideen had contacted television stations to claim credit.

Whether or not such a group really exists, suspicion will inevitably fall on Islamist extremists. Moreover, the tactic—familiar from New York's twin towers to the London Underground—of simultaneous assaults on "soft" targets, designed to kill large numbers of civilians, suggests an al-Qaeda involvement, or at least that the group has provided an inspiration. This is deeply worrying for India, which until recently thought itself immune from that particular scourge. Introducing Manmohan Singh, India's prime minister, to Laura Bush a few years ago, George Bush reportedly noted that India was a country of 150m Muslims and not a single al-Qaeda member.

Home-grown poison

In the past, terrorist attacks in India were routinely blamed on foreigners. This usually meant Pakistan, either as part of deliberate government policy or as the work of rogue elements of the state apparatus, or occasionally Bangladesh, also suspected at times of tolerating terrorist training camps on its soil. But in recent months a series of attacks in Delhi, Jaipur, Bengalooru (Bangalore) and Ahmedabad have been claimed by the "Indian Mujahideen". Indeed, this group, which the government since claims to have

dismantled, had explicitly threatened to carry out "deadly attacks" in Mumbai.

India's Muslim population does indeed look like fertile ground for those sowing hatred. Although there is a general impression that the two-decade-long insurgency in Indian-administered Kashmir—the country's only Muslim-majority state—is in remission, it still festers. Last year the conflict killed more than 800 people. This year more than 30 unarmed demonstrators were killed in mass protests against Indian rule. Tension there is again high as a state election, which separatist leaders want boycotted, is under way. Elsewhere in India, the Muslim minority is economically disadvantaged. A report the government commissioned in 2006 found Muslims across the country faring, on average, worse than the Hindu majority in education, jobs and income. And Muslims have occasionally been subject to hideous communal slaughter. More than 2,000 died in a pogrom in the state of Gujarat in 2002, for which the perpetrators have never been brought to justice.

That pogrom followed allegations that a Muslim mob had been responsible for the deaths of Hindu activists. This highlights one of the dangers facing India now: of a rise in communal tension and tit-for-tat violence. A general election is due by next May, which adds to the risks. One of India's two biggest parties, the Bharatiya Janata Party, now in opposition, champions the rights of India's Hindus. Accusing the Congress-led government of being "soft on terrorism" is a campaign tactic it has often used. In this it may now be constrained by the recent arrest of alleged Hindu bombers, seeking to avenge the attacks by the Indian Mujahideen. But the emergence of that new phenomenon—Hindu terrorism—is scarcely a comfort.

The usual suspects

A second danger is that if Indian suspicions again point to a Pakistani involvement, the slow thawing of relations between the two hostile neighbours will revert to the deep freeze. In fact Pakistan's new president, Asif Zardari, has been going out of his way—and courting controversy at home—to placate India. He has annoyed jihadists by describing Kashmiri militants as "terrorists" (as India has long wanted them to be known). And he has said Pakistan would never be first to use its nuclear weapons. This week it has also emerged that Pakistan's Inter-Services Intelligence, the spook network habitually blamed by India for involvement in cross-border attacks, has been revamped. Its "political" arm (previously, in theory, non-existent) is said to have been disbanded. So any official Pakistani involvement would suggest that Mr Zardari and his government are not in control.

A third danger is one that faces not just India, but the world as a whole: that the attacks in Mumbai mark a serious setback or even turning-point in the battle against al-Qaeda and its clones. The group has been losing ground in some of the Muslim countries where it has been fighting: in Indonesia, for example, where since the Bali bombings in 2002 the extremists have been in retreat; or in Iraq, where the Sunni "awakening" illuminated the resentment many Iraqis felt for the terrorists. Killing fellow Muslims has been the group's biggest mistake. But countries where Muslims are in a minority may offer terrorists a better target. Many Muslims in such places feel marginalised, pushed to the fringes of society. Attacks there can provoke a backlash, feeding a sense of Muslim beleaguerment for al-Qaeda to exploit. This tactic has already worked in places such as Britain. If it succeeds in India, which has the biggest Muslim minority in the world, the implications for the global struggle against terrorism could be catastrophic.

The world economy

The perils of incrementalism

Nov 27th 2008
From The Economist print edition

Bold, unorthodox remedies are needed to jolt the world economy back to life

Illustration by James Fryer



THE prognosis is looking ever more grave. What began 15 months ago with a seizure of the credit markets has become a disease with an alarming list of real economic symptoms. America, Britain, the euro zone and Japan are already in a recession that threatens to be the worst, in some places, for a quarter of a century and possibly since the Depression. American consumers, unable to borrow and fearful for their jobs, are cutting spending; so are firms, short of cash and worried about sales. German business confidence is at a 15-year low. Japan's exports to both rich countries and emerging ones are falling. Emerging economies are suffering too, as commodity prices fall and capital flees faster than in those countries' own crises of a decade ago. In some countries—notably the United States—a vicious deflationary spiral of banks withdrawing credit and demand contracting is no longer unimaginable.

Seeing the threat to the world economy's vital functions, the policymakers have been working overtime. Interest rates have been cut dramatically. American rates are already down to 1%; Britain's are at a 50-year low; and this week China's central bank lopped 108 basis points off its main policy rate. Hundreds of billions have been pumped into banks and financial markets. Many financial institutions have been bailed out: the rescue of the once mighty Citigroup (see article) is merely the latest unthinkable to happen.

Despite all this, the patient has not responded. This is partly because some traditional remedies, such as looser monetary policy, are weakened in a credit crunch. It is also because the doctors have been ham-fisted: look at Hank Paulson's changes of mind about whether to use America's $700 billion rescue fund to recapitalise banks or to buy toxic assets. In addition, though, a lot of policy has been far too timid. Halting the world economy's decline will demand something rather bolder than anything seen so far in this crisis.

Sense and the Citi

That means redoubling existing efforts in each of the three traditional areas of policy: bolstering banks; providing greater fiscal stimulus; and cutting interest rates. It also involves using more unorthodox tools, such as interfering directly in credit markets by buying up assets—a route where America's Federal Reserve has shown the most creativity. Indeed, such "quantitative easing" is an augury for the option to be tried in extremis: reflating the economy by printing money to finance budget deficits. That risks inflation, which is economic poison; but, in highly indebted countries, it is less murderous than deflation.

Mercifully, the world is not at that stage yet. But it is getting closer. One person who seems to understand the need for action on a bigger scale is Barack Obama. In his various press conferences this week America's president-elect laid out the nature of the challenge better than many leaders already in

office. This was a “global crisis”, he argued, which merited a “global response”. The economy was “trapped in a vicious cycle” and needed a big “jolt” to ease the flow of credit and to cushion the drop in private demand. He is right.

The starting-point for many policymakers remains lowering interest rates. Central banks in some rich economies, in particular Britain and the euro zone, still have room to cut rates—though it is notable how even fairly dramatic cuts are not working as they once did. The Bank of England reduced rates by one and a half percentage points in one go this month. But with banks reluctant to lend, lower rates from central banks will not work miracles.

That suggests there is a lot to be gained in most places by concentrating more on the banks. The fact that Citigroup, the world’s biggest bank not so long ago, needed a rushed weekend rescue was an indictment of the authorities’ failures thus far, especially in America. Above all, Citi’s collapse showed the dangers of leaving huge quantities of toxic assets to fester on banks’ balance-sheets. Pumping in capital—as governments have been doing—is essential, but may not be enough. The history of successfully handled banking crises, such as Sweden’s in the early 1990s, suggest that governments also need to remove bad assets from banks’ balance sheets.

It would be good to report that the Citi deal provided a new model. Not really. The rescue is opaque—yet another ad hoc bail-out rather than part of a systematic plan; and it is too kind to the bank’s management, board and shareholders. Granted, the rescue ring-fences and limits Citi’s losses on a pile of the worst loans. But it would probably have been better to hive off its most toxic assets into a separate “bad bank”.

The charm of unorthodoxy

Looking ahead, governments in rich countries will need to do more to help their banks on both fronts—injecting capital and buying up assets. That would mean admitting to the scale of the problem: America may need more than the $350 billion left in the Treasury’s financial-rescue fund.

A more stable banking system will eventually get the money flowing, but in the meantime there are other ways. Intervening directly in credit markets makes a lot of sense in America, which relies more than other countries on non-bank finance and where official interest rates are hard to cut further. This is where the Fed has already been inventive: printing money to buy all manner of assets. In October it said it would buy short-term commercial paper. This week it unveiled two new schemes: a $600 billion plan to reduce mortgage rates by buying government-backed mortgage securities and the debt of America’s state-sponsored mortgage giants; and a $200 billion scheme to buy the debt backed by credit-card, car, small-business and student loans (see article). This approach could be broadened to other markets that have shut down. For instance, there is little fresh (senior) credit for firms in bankruptcy. If the government can provide that cash, it could stop the coming wave of bankruptcies from becoming one of corporate liquidations.

However, all the bank rescues, credit interventions and looser monetary policy will only get the world so far. The biggest part of Mr Obama’s “jolt”, as he made clear, must be fiscal. When private demand sags so dramatically, the public sector must step in to boost spending, and boldly enough to make a difference. In America, although Mr Obama has refused to give a figure, talk among Democrat bigwigs is of a fiscal boost worth $500 billion-700 billion, or 3-5% of GDP.

So far the only other big country to conjure up sums on this scale is China (and its huge stimulus keeps on having to be revised downward as the figures are checked). Some of the timidity in Europe is explicable: its generous welfare states have more “automatic stabilisers”, such as payouts to unemployed workers, to support economies in recessions than hard-hearted America does. Even so, the Europeans have hardly impressed with their daring.

This week Britain’s chancellor laid out tax cuts worth 1% of GDP, but coupled these with a counterproductive plan to raise income taxes on high earners later (see article). The European Commission has proposed a fiscal boost, across the European Union, of €200 billion ($258 billion), or 1.5% of GDP, but its proposal seems unlikely to be taken up enthusiastically by member states. Germany, the EU’s biggest country, has both the heft and the money to loosen budgetary policy. Yet the government’s recent boost, amounting to just 0.25% of GDP, hardly suggested urgency.

Plainly, not all countries can afford precisely the same dose of fiscal stimulus. Those reliant on skittish

foreign capital have less room to take action than those countries with large amounts of domestic saving. But cautious incrementalism, ironically, risks letting the world slip ever further down the deflationary spiral. It is time to follow Mr Obama's lead and jolt the patient back to life.

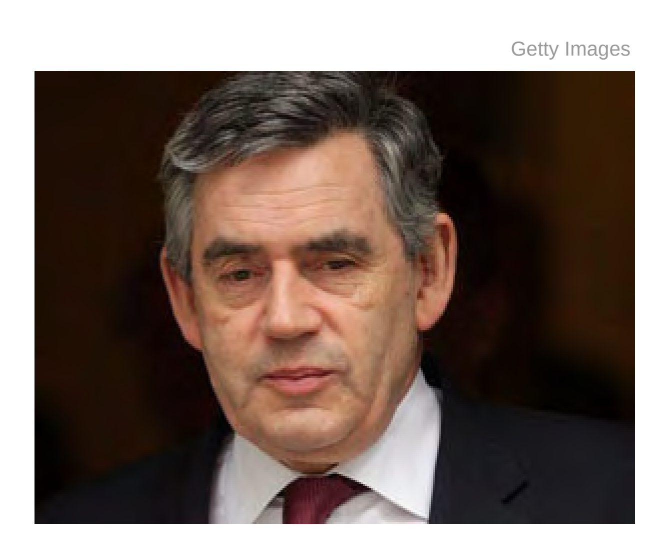
The British economy

Farewell, New Labour

Nov 27th 2008
From The Economist print edition

Gordon Brown's fiscal stimulus has set the agenda for the next election

Getty Images



ONCE they started falling, the totems toppled like ninepins this week. For 11 years, New Labour preached the gospel of fiscal prudence: money would be borrowed only for investment, and public net debt kept below 40% of GDP. Economic boom and bust were over; steady prosperity was the shape of things to come. Against this benign background, Britain's rulers felt "intensely relaxed" about the prospect of people getting filthy rich: in three elections Labour pledged not to raise the top rate of income tax, set at 40% in 1988.

Not one of these pillars has survived the revelations in this week's £20 billion ($31 billion) fiscal-stimulus plan. Borrowing will hit 8% of GDP in 2009-10 and debt 57% of GDP in 2012-13, even on the government's optimistic assumptions. The Treasury predicted in March that the economy would grow by 2.5% next year; it now thinks output will shrink by 1%. And a new 45% tax rate for the rich will be imposed from 2011. New Labour's compact with the aspiring middle classes has collapsed, and what happens next is anyone's guess.

The package that Gordon Brown, the prime minister, and his chancellor of the exchequer, Alistair Darling, have come up with will cut value-added tax (VAT) temporarily, give income-tax and other relief mainly to those on lower incomes or struggling with precarious jobs and mortgages, support small businesses and bring forward capital spending (see article). All this is to be paid for by a later squeeze on public spending, an increase in national-insurance (social-security) contributions and higher income taxes for the rich—after, needless to say, the next election. Will the package work, and what will it do to the political landscape?

The government's economic ambition—shaving up to half a percentage point off a recession that looks set to be the rich world's grimmest—is hardly vaulting. By itself, the stimulus seems modest, equal to about 1% of GDP rather than the 2% the IMF urged on countries that could afford it, and far less than the Americans are now contemplating. The cut in VAT may hardly be noticed amid the flurry of retailers' frantic price-slashing—and many of the benefits will be felt abroad as Britons buy more foreign goods. Extra help for those with children and for pensioners is rightly targeted on those likely to spend most, but the amounts involved per family are peanuts. And the prospect of heavier national-insurance contributions from 2011 will surely put firms off hiring people.

Yet this modesty must be put into context. Tax revenues are set to plunge faster in Britain than in many other rich countries, thanks to a collapse in receipts from finance and property. Add in the spending, on unemployment benefits and so forth, that increases in a recession, and Britain will get a hefty rise in the

budget deficit—and a commensurate fiscal boost—without the government lifting a finger. British manufacturers have already been helped by sterling's slide. And the Bank of England still has more room to cut interest rates than many of its peers.

Soak the rich; it was such a success last time

The politics revolve around how to pay for the stimulus—and both parties have made fundamental errors of judgment. The Tories' decision to oppose all unfunded tax cuts is a classic example of cutting off your nose to spite your face. Yes, fiscal discipline is important; but in times as dire as these stimulus is needed and stimulus, if it is to have any effect, has to be unfunded, at least in the short term. The Tories should have accepted that—and reminded people that the boost could have been bigger if Labour had not blown so much cash earlier.

Mr Brown's error may be still graver. New Labour came to power in part because it persuaded upwardly mobile Britons that it had given up the politics of envy and resentment. Since then business has put up with ever more red tape and stealth taxes (Britain's state is now bigger, as a share of the economy, than Germany's). Mr Brown could have balanced the books in the medium term by slimming this bloated monster. Instead, he is playing to the gallery with the new 45% tax rate for the rich. This will affect only 1% of earners, raising at most £1.6 billion a year—and it runs directly against the enterprise culture Mr Brown once sought to foster. This looks like gesture politics of the class-war sort. Farewell, New Labour.

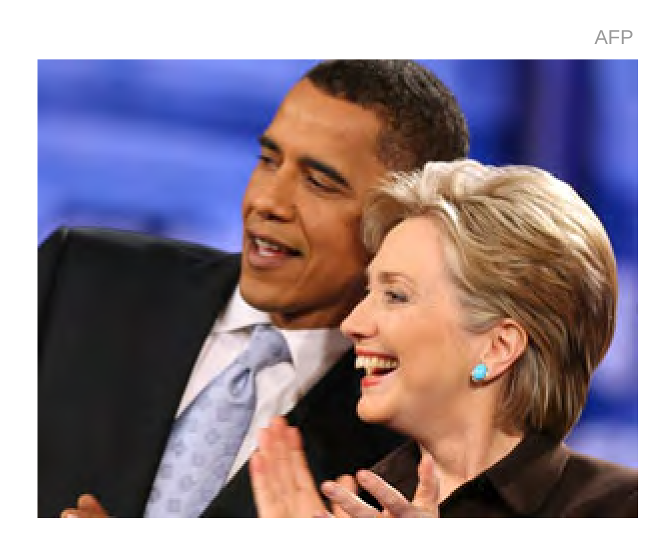
Barack Obama's team

So far, so very good

Nov 27th 2008
From The Economist print edition

The president-elect is proceeding with all deliberate speed

AFP



IN THE absence of any real detail about what he plans to do, it is Barack Obama's staff choices that provide the best indications as to what sort of president he will turn out to be. And so far the signs are encouraging, both in terms of the process and the results. Mr Obama is moving much faster and more smoothly than most incoming presidents manage—without rancour, hiccups or (unplanned) leaks. And his choices are reassuring, especially for those who feared a shift to the left.

On the economic side, by giving the two main jobs to pragmatic centrists—Tim Geithner for treasury secretary and Larry Summers to chair the National Economic Council, the White House body that co-ordinates economic policymaking—Mr Obama has shown that he values experience over ideology, and competence over personal loyalty (see article). Some of those who worked hardest to get him elected have had only meagre reward for it, whereas Mr Geithner is someone whom Mr Obama does not know well. The appointment of Peter Orszag, a noted critic of lax spending, to run the budget office is another good move: it hints that Mr Obama will be a spending hawk as well as a stimulator. On the security side, by keeping on George Bush's first-rate defence secretary, Robert Gates, and (probably) by choosing a former general, Jim Jones, as his national security adviser, Mr Obama is showing that he will not let himself be tagged with the "Defeaticrat" label.

There are, of course, a few potential pitfalls. For every rational businessperson reassured by the fact that Mr Obama has appointed economically literate free traders, there will be a union leader moaning that a bunch of Clintonian retreads will never deliver the change America needs. Mr Obama will need to manage the threat of disillusion among some of his more enthusiastic supporters with some care. As things look now, he should be able to deliver on the issue that many on the left care most strongly about, a phased withdrawal from Iraq (see article); and he is also likely to please them with the scale of his stimulus plans. Other sops to the left—notably the removal of secret ballots for union votes—look more dangerous.

The other worry concerns a couple of management issues. Many people had expected Mr Summers to return to his perch at the Treasury. It is not clear whether Mr Summers, brilliant but opinionated, is really the ideal man for the nominally junior role at the NEC, involving the forging of consensus.

Worth a Hill of beans

Then there is Hillary Clinton. Many of Mr Obama's advisers are horrified by the idea that she will become

secretary of state, pointing out not just that Mrs Clinton is surrounded by people who loathe him, but also that she has a bad track record as a manager (her presidential campaign and attempts at health reform in the 1990s are two examples) and that scandal seems to dog the Clintons wherever they go. On the other hand, Mrs Clinton is intelligent and formidably hard-working and has undoubted star power. She has seen a lot of the world and takes a close interest in the Middle East. She also showed that she could be a team player in the Senate (a period when her husband stayed more firmly in the background).

On balance, this is a gamble just worth taking—not least because it puts the onus on Mrs Clinton to make it work. She will have to give up her Senate seat. If she lets those around her resort to their old tricks, she will suffer most. If she focuses her remarkable energy on the task at hand, she could achieve a lot.

America and Iraq

Well, is it victory or humiliation?

Nov 27th 2008
From The Economist print edition

No happy ending, but the final chapter of the Iraq saga remains to be written

AFP



WHO would have thought, when John McCain and Barack Obama were going head-to-head on Iraq during America's election campaign, that the Iraqis would decide for themselves when to sling the Americans out? That, however, is precisely what they did this week when Iraq's government approved a troop-withdrawal agreement which the government of Nuri al-Maliki had spent a year squeezing out of its reluctant American interlocutors.

The agreement under discussion stipulates that American troops will withdraw into their bases by the middle of next year and leave Iraq altogether by the end of 2011. This is, on the face of it, a firm timetable. It contains very few ifs and buts and no clauses that give America the right to linger on uninvited. Iraq, it seems, will not be a home for the permanent military bases that some Americans wanted and many Iraqis feared. And even during the transition America has now promised not to use Iraq as a base from which to attack neighbours such as Syria (which it has raided openly at least once from Iraqi territory) or Iran (which it may also have attacked covertly).

As with every other twist in the Iraqi saga, the meaning of this latest turn is fiercely contested. Does it mark an astonishing American victory, snatched from the jaws of defeat? That case can certainly be made. In 2006 a panel of "wise men", led by James Baker and Lee Hamilton, told Congress that America was failing in Iraq and had better start to withdraw. Under their plan, the bulk of America's combat forces would already have gone by now. George Bush defied them, choosing instead to send even more troops. Now—thanks to that "surge" and the Sunnis' rejection of al-Qaeda—the country is mostly at peace and has a democratically elected government confident enough to send its protectors home. So much for the idea that this was a regime of quislings designed to secure Iraq's oil for America and serve the superpower's colonial ambitions.

To Mr Bush's detractors, by contrast, the withdrawal agreement is no victory, only the final humiliation in a miserable sequence of calamities that flowed from a misbegotten war. On this view, America is agreeing to leave only because its original designs have been comprehensively thwarted and it has no choice. When the troops go home, democracy will strike no lasting roots in the dust of Mesopotamia. Iraq will either collapse back into chaos, return to dictatorship, or fall under the spell and indirect control of Iran, its theocratic neighbour and America's arch-rival in the Persian Gulf. Less mission accomplished than the mother of all American own-goals.

In truth, neither version is right. Mr Bush's refusal to cut and run two years ago was indeed a good call, one history may judge to have stopped Iraq's descent into an ever-blacker hell of sectarian killing and

ethnic cleansing. But a prodigious quantity of killing and cleansing had taken place already, and no reader of our briefing this week (see article) could in conscience declare "victory" in a place the American invasion and subsequent civil war ended up laying waste. Iraq remains violent and fractious and its political institutions are weak. It has the potential at any moment to unravel all over again.

And yet to predict that Iraq is therefore destined to collapse into new chaos, or split into Shia, Sunni and Kurdish fragments, or become a satellite of its Persian neighbour, is too pessimistic. Though possible, none of these outcomes is inevitable. Iraq is rich in oil and—if its fugitive middle class starts to drift home—human resources too. Having looked into the abyss, Iraqis know, and are keen to avoid, the dangers of sectarian division. And though Iraq's Shias are close to Iran, its Shias and Sunnis share an identity as Arabs that may encourage them to resist a Persian takeover of their politics. When America departs, a lot of Iraqis will want Iran to butt out too.

Don't rule out the possibility of democracy

Something else may change as well. Several of the most disruptive forces in Iraqi politics, such as those of the militant Shia cleric, Muqtada al-Sadr, who wants something close to an Iranian theocracy for Iraq, have built their appeal on the notion of resisting the infidel. When the infidel goes, the resisters will have to put forward a more concrete vision of the sort of Iraq they want. And now that Iraqis have had a taste of multi-party democracy, however brief and imperfect, it remains to be seen which vision they will choose.

Sri Lanka

The illusion of victory

Nov 27th 2008
From The Economist print edition

The government may finally have "won", but ethnic conflict cannot be ended on the battlefield alone



LITTLE is known for certain about the fighting under way in northern Sri Lanka. The belligerents—the Sri Lankan army and the rebel Liberation Tigers of Tamil Eelam—issue contradictory claims, and the area is closed to independent observers. Three things, however, seem clear. The 25-year-old war, in which the Tigers have been seeking an independent homeland in the north and east for Sri Lanka's Tamil minority, is in an especially grim and bloody phase, made worse by the monsoon rains. Second, the fighting is causing human suffering on an enormous scale, with more than 200,000 people displaced and living in dangerous, miserable conditions. Third, the Sri Lankan army is on the offensive, and believes a victory is in its grasp. Any such victory, however, will be hollow without a political settlement; and sadly there is little sign the government is sincere about pursuing one.

By mid-week the army claimed to be closing in on three fronts on the Tigers' headquarters at Kilinochchi. Its spokesman said soldiers were in the outskirts of the town, whose fall was imminent. That would be a big symbolic victory, to add to a series of strategic gains made in recent weeks. It would boost the government's standing among its main supporters, from the ethnic-Sinhala majority in the south. But it would not end the war; still less resolve the conflict that fuels it.

Few neutrals could regret the defeat of the Tigers and their brutal leader, Velupillai Prabhakaran. Pioneers of suicide-bombings, they have an appalling record of terrorism, assassination, extortion, kidnapping and the conscription of children as soldiers. They have been especially vindictive towards those Tamils who have refused to toe their line. But partly for that reason, they have succeeded in dominating ethnic-Tamil politics. Rather than cheer a government victory over the Tigers, many Tamils would mourn what they would see as a defeat for their hopes of a fair deal in the Sri Lankan polity.

The peace dividend

The awfulness of the Tigers has enabled the government to present the war as a fight against the scourge of terrorism that must first be eliminated before a political solution can be contemplated. In this, it has in effect ditched all three parts of a long-held consensus about the conflict: that there can be no purely military solution; that a political solution must cover both the north and the east; and that it must go beyond the limits of Sri Lanka's existing "unitary" constitution.

Yet all three elements remain true. Lasting peace depends on a durable settlement in the east, now under the sway of a breakaway faction of the Tigers that joined the government side and won elections. And without significant devolution to the Tamil-majority areas—beyond that envisaged in the present

constitution—it is hard to see how the aspirations of even moderate, Tiger-hating Tamils can be met. The government of President Mahinda Rajapaksa has hinted it is prepared to go beyond the bounds of the constitution to offer Tamils the hope of a workable deal. It is time for more than hints. What are needed are clear signs that its aim is not victory, but peace.



On Spain and Catalonia, AIDS, the Republican Party, the financial system, chess

Nov 27th 2008
From The Economist print edition

Spain and its regions

SIR – I read the references to Catalonia in your special report on Spain (November 8th). Catalonia is a small nation, but for the past 1,000 years it has shown a clear will for self-government. The new Statute of Autonomy has not "gone too far", as you suggest. It goes as far as has been democratically agreed between citizens and their political institutions.

You described our language as "an obsession for the nationalists". Since 1979 parliament and government have viewed the Catalan language as an important tool for social promotion and integration (which is not the same as assimilation). The government aims to make sure that all its culturally diverse citizens have equal opportunities. That is why we are, for instance, taking measures to ensure that pupils in Catalonia leave school fully competent in Catalan, Castilian and English. We are determined that Catalonia remains competitive in the 21st century, but without losing its important cultural heritage.

Finally, it is unfortunate that you described Jordi Pujol as a "*cacique*". This is a politically incorrect term used to describe politicians who abuse their power. It is totally unacceptable when talking about the man who was the democratically elected president of Catalonia for 23 years.

Xavier Solano
Head of Catalonia's government delegation to Britain
London

SIR – Catalonia was mostly monolingual until the Spanish civil war. In the 1950s and 1960s it witnessed an extraordinary inflow of workers from the rest of Spain, which doubled its population. Although this was welcomed, linguistic integration was impossible under Franco's dictatorship, which banned Catalan in schools and the public arena. After the restoration of democracy and of regional autonomy the Catalan government introduced bilingual education. This system has been contested by the Spanish right, but Spain's constitutional court has upheld the policy.

Furthermore, you were imprecise about the financial architecture behind the Spanish system of autonomous communities. Due to an exaggerated application of the principle of inter-regional solidarity, the difference between total taxes paid by Catalonia and public spending fluctuates between 7% and 9% of Catalan GDP, far more than in any other European region. As a result, some Spanish regions where pre-tax income per head is lower than in Catalonia end up with higher post-tax income.

Carles Boix
Professor of politics and public affairs
Princeton University
Princeton, New Jersey

SIR – Catalonia's linguistic policy penalises the Spanish language. Schools treat Spanish as a foreign language and there is no legal way to study in Spanish at university. No official aid is given for presenting a project in Spanish. Spanish-speakers are ostracised through many measures. I will live in Madrid, or move back to America, as I do not want to be a second-class citizen in my own country.

Helena Medina
New York

SIR – As an employer in the technology sector I am frustrated at how technology work has gravitated elsewhere. Catalan politics is based on clumsy parochialism, dead-end linguistic nationalism and an astonishing amount of whining about our treatment by the rest of Spain. Our leaders would be well advised to take a shot of the *café para todos* you mentioned and recognise that while we talk, others do

business in whatever language is necessary.

Adin Seskin
Barcelona

SIR – You obviously think highly of Spain's "extraordinary transformation" since 1975 and its "swiftly consolidated" democracy. Yet Spain's two big parties, the People's Party and the Socialists, devolve few decisions to their members. Party leaders decide electoral lists, leaving little room for independent candidates with new ideas, never mind mavericks who wish to transform the lives of Spaniards. A strict disciplinary system causes deputies to vote consistently in line with their party.

Jesús García Barcala
Madrid

SIR – You have been writing about Spain's splendid ten years of economic growth until only very recently. It is a shame you were not able to forecast sooner the collapse in our economy despite the abundant signs: an extreme dependency on construction and tourism, very low productivity, poor rankings in education on every international indicator, a stiff labour market, obstacles to starting a business, the end of the flood of money from Brussels, etc. Our problem is that others will recover from the international financial crisis in the short-term, whereas Spain will head towards an irremediable and complete Italianisation.

Adolfo Contreras
Madrid

Facts about AIDS

SIR – You published an article on science research that contained a major error ("All colours of the brainbow", October 11th). It stated that "Dr [Robert] Gallo had initially suggested that AIDS was caused by HTLV-1, a virus that no one disputes he discovered." Yes, my colleagues and I discovered HTLV-1 in 1980 and HTLV-2 (the second known human retrovirus) in 1982. However, I never stated that HTLV-1 was the cause of AIDS.

In May 1982 my colleague, Max Essex, and I were the first to propose that AIDS was probably caused by a new human retrovirus. Our hypothesis was that the new AIDS-causing retrovirus would be in the HTLV family. In 1983 my group obtained many independent isolates of a new retrovirus from AIDS patients. Prior to submitting this research for publication, our lab produced 48 samples of this virus and at first called it HTLV-III, to designate it as the third known human retrovirus. This was in keeping with an international nomenclature agreement at Cold Spring Harbour in September 1983.

Soon after, a group met to designate the generic name to these virus isolates as HIV. However, one journalist writing in the early years of HIV/AIDS in the United States fanned the notion that I said HTLV-1 was the cause of AIDS. Unfortunately, this inaccuracy continues 25 years later.

It would have to be remarkably senseless of me to think that HTLV-1 itself caused AIDS. This is in view of the fact that we knew HTLV-1 was a very ancient infection of humans and AIDS was a relatively new disease spreading rapidly. HTLV-1 spread very slowly, caused leukaemia, neurological disease and minor immune impairment, but never major immune impairment as occurs in AIDS.

Dr Robert Gallo
Director
Institute of Human Virology
University of Maryland
Baltimore

The angry right

SIR – Lexington's screed about the Republican Party's "idiocy" (November 15th) managed the neat trick of modelling the behaviour it purported to denounce. Notable amid its fusillade of egregious falsehoods was the contention that Republicans were defeated in the election because they marched into battle

armed with empty slogans ridiculing the threat of global warming, pandering to anti-immigrant nativism, condoning water-boarding, and so on. Lost on the author of this empty sloganeering was the party's emphatic nomination of John McCain, a paragon of reasoned concern about climate change, the pursuit of sensible immigration reform, and opposition to torture.

American conservatives, whose championing of thoughtful reforms of welfare and public education have fuelled some of the era's more notable policy successes (welfare reform and charter schools), were surely surprised to read that they have "lost patience with brains".

Jon Keller
Boston

SIR – Your ridicule of Sarah Palin could have come straight from MSNBC or the *New York Times*. Governor Palin has accomplished a lot in a relatively short period of time and along with other Republican governors like Bobby Jindal, Tim Pawlenty, Charlie Crist, Mark Sanford and Matt Blunt, represents a new generation of party leaders, none of whom you mentioned.

Steve Sisneros
Dallas

SIR – There is nothing conservative about present-day Republicans. They are, for the most part, a bunch of yahoo radical populists wallowing in racism, jingoism, intolerance, obscurantism, corporate lollipops galore, fiscal irresponsibility, executive abuse of power, and supine legislatures. Edmund Burke would spit on them. True conservatism recognises that the world is a dauntingly complex place, that unforeseen harm can often overwhelm the benefits of well-meant action, and that we are never as smart as we think we are. It takes brains, lots of them.

Bruce Morley
Jaffrey, New Hampshire

Bretton Woods 3?

SIR – Your analysis of the prospects for redesigning global finance at the G20 meeting in Washington didn't inspire much confidence that things will change ("After the fall", November 15th). Financial markets and stockmarkets have overstepped the mark on countless occasions before. The 1980s stockmarket crash and the technology crash at the beginning of this century, and their subsequent recessions, did little to fix the fundamentals of the world's financial system. The current crisis is unlikely to alter the situation.

One possible fix would be a big expansion of the Bank of International Settlement's reach and regulatory power, putting it on a par with the IMF and World Bank. A global financial market requires global regulation and a regulator large enough to bail out banks when necessary, taking the burden off national governments. The membership of the BIS board could be updated so that all G20 nations, and others, are represented, according to their relative economic size. This should reduce the clout of the IMF and the stigma of borrowing from an international body.

Brad Ruting
Sydney

SIR –*The Economist*'s cover of November 15th featured a globe with Iceland wiped from the face of the earth. Iceland is facing tough times at the moment, but anyone who knows Icelandic history also knows that Icelanders are not going to be wiped out.

Gudni Thorsteinsson
Ponte Vedra, Florida

Chess pieces

SIR – You noted that the Saudis play chess without a queen ("An earlier envoy", November 8th). I have a chess set from a bazaar in Tehran that has a bearded queen/vizier. I was put right about the lack of a

bishop; in my set, the castle-like piece represents a minaret, the power of religion, and the elephant is for a strong point in battle and is equivalent to the castle. As a poor chess player, I took full advantage of the confusion when my opponent tried to move the minaret/bishop horizontally.

James Balfour
Sydney

Iraq

Is it really coming right?

Nov 27th 2008 | BAGHDAD, ERBIL AND MOSUL
From The Economist print edition

In most of Iraq, violence has plummeted and the Americans under a new president look set gradually to withdraw. But will the battered country hold together?

Eyevine



IT SHOULD be momentous. In Baghdad in the middle of this week, after fierce debate and protests on the streets, Iraq's fractious parliament at last voted to approve a withdrawal agreement with the United States, under which all American troops will leave the country by the end of 2011. And yet the mood of this exhausted country is far from jubilant.

In Mosul, 320km (200 miles) north of Baghdad up the Tigris river, the governor of Nineveh province, Doraid Kashmoula, furrows his brow, fiddles with his worry-beads in one hand, stubs out yet another cigarette with the other and reels off a litany of woe in his dankly curtained office. The scion of a prominent Sunni Arab family, he took the job two years ago after his predecessor, his cousin, was assassinated.

Since then he has survived half a dozen murder attempts. His son, a brother and four cousins have been killed by insurgents. His house has been burnt down. He is protected both by the Kurdish guerrillas, who control the eastern half of the city and a clutch of fortified government buildings in the western half, and by the Iraqi army and police, with American forces at their shoulder, when he ventures farther afield.

"Security is slowly getting better," he says, without much conviction. At present the insurgents carry out about ten attacks a day in his province, including car bombs and ambushes, mostly in the vicinity of Mosul. In each of the past four months, more than 100 civilians and about a score of army and police have been killed, according to official figures.

The provincial council's chairman, another Sunni Arab, tells a similar tale. From a drawer in his desk he takes a sheet of paper displaying 12 coloured photographs of "martyrs": four brothers and eight cousins, all murdered because of their kinship to himself. A councillor representing the Iraqi Islamic Party (IIP), a long-established Sunni outfit which heads the main Sunni block in the national parliament and is led by one of the country's two vice-presidents, Tariq al-Hashemi, says that 420 of his party members in Mosul have been killed in the past two years. Nineveh's deputy governor, a Kurd, says that 1,600 of his people in Mosul have died at the hands of insurgents since the American invasion—as have "many more Arabs".

Nobody knows how many insurgents operate in the area. Maybe 5,000, says the council chairman, describing a spectrum from al-Qaeda fanatics to secular Baathists. "Plus a million supporters," he adds,

with a mirthless laugh. As the Americans and their Iraqi army allies successfully hunt them down elsewhere in Iraq, many have gravitated to Mosul. It is close to Syria, from which foreign jihadists still infiltrate. The city has a history of Baathist loyalty to Saddam Hussein and hostility to the Shias, who count for barely 5% of its people.

Iraq's multiple fault-lines are especially visible—and occasionally bloody—in Nineveh and Mosul. Some towns in the province have a record of Shia-Sunni enmity. Nineveh has Iraq's largest minority of Christians, themselves divided into various sects, some speaking Aramaic, the language of Christ. In a northern arc dwell the Yazidis, more than 500,000-strong they claim, who follow an ancient religion that reveres a Peacock Angel; many Muslims damn them as devil-worshippers. Then there are the Shabaks, who claim descent from Persians and follow various brands of religion, including Islam. There are also the Turkomens, stay-behinds from the days when Mosul was the capital of one of the three Ottoman *vilayets* (administrative regions) that were crudely lumped together to form Iraq when the Turkish empire collapsed after the first world war.

Perhaps the biggest and currently the scratchiest division is between Arabs and Kurds, who control most of the east and north of Nineveh, and account for about one-third of its population. Most of the Sunni Arabs, the province's largest group, boycotted the last elections in 2005, so the Kurds ended up with a disproportionately large chunk of the provincial government (31 out of 41 seats in the council) and hold sway over the hapless Mr Kashmoula and the council chairman, whom the insurgents curse as puppets and traitors.

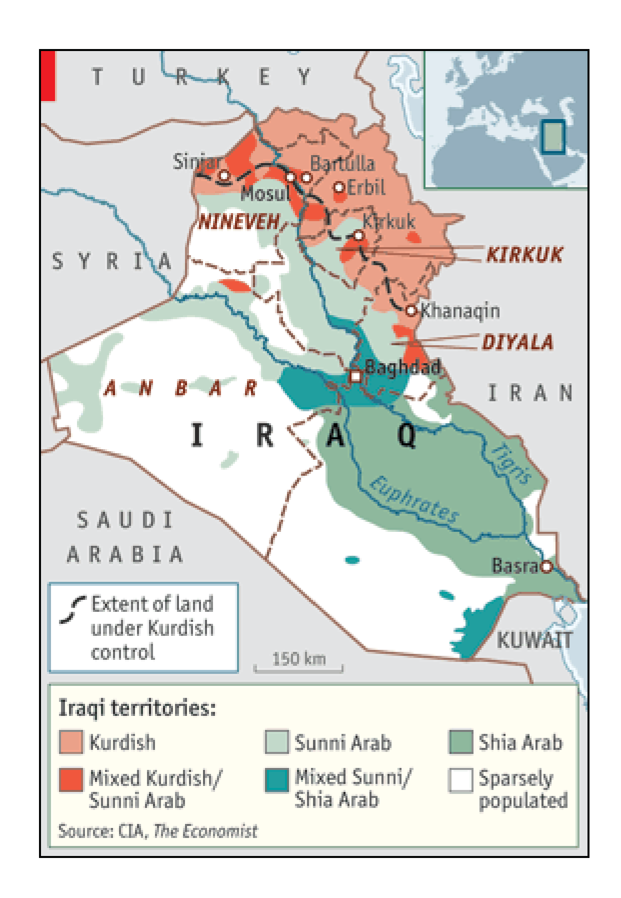
But this may soon change dramatically because the Sunnis are set to contest provincial elections due on January 31st, when they may well oust the Kurds from local power. To minimise their expected losses, the Kurds are bent on ensuring that all the non-Sunni minorities, such as the Christians, Yazidis and Shabaks, vote for a Kurdish-led list of candidates.

Many people from these small minorities, together perhaps more than a tenth of the province's people, say that the Kurds, who control the territory where most of them live, are trying to intimidate them into voting their way. The Kurds, they say, are even attempting to frighten them into fleeing east into areas more firmly controlled by the Kurdish Democratic Party (KDP) from its headquarters in Erbil, capital of the Kurdistan Regional Government.

In Sinjar, west of Mosul, some Yazidis, who predominate there, say the Kurds want to force them to vote for the Kurdish list. Not only would that mean increasing the Kurds' chances of holding on to the provincial council. It would also strengthen their case to have such places as Sinjar, which are technically part of Nineveh, eventually transferred formally to Iraq's Kurdistan region, whose area the Kurds seek to widen as much as possible.

The Christians have been hammered, in Nineveh as in the rest of Iraq: their numbers throughout the country are said to be down from 800,000 in 2003 to around 250,000 today. Earlier this year the archbishop of the ancient Chaldean church was abducted in Mosul and murdered. In October, some 10,000 Christians fled into Kurdish-held areas from close to Mosul after a dozen of them had been killed. No one is certain who the culprits were.

In any event, tension is rising across the ethno-sectarian board: between Kurds and Arabs; between Sunnis who have co-operated with government and the larger number who have not; between Kurds and minorities; and within the minorities themselves. "If we [Christians] had guns we'd kill each other too," says a prominent Chaldean Christian. "If Mosul was peaceful, we'd want to stay in Nineveh," says a leading Christian businessman in the town of Bartulla, just east of Mosul. "But if it isn't, we'd like to be part of Kurdistan."



But there is a gleam of hope that in Nineveh, as elsewhere in Iraq, the coming provincial elections may shift the dynamic of Iraqi politics, pave the way for more genuinely representative government and make it harder for the insurgents to hold the loyalty of the disgruntled. The key is that, unlike last time, the Sunni Arabs are expected to vote en masse. If Nineveh's council took on a Sunni nationalist hue, the insurgents might be in trouble.

Shaking the political kaleidoscope

Nuri al-Maliki, Iraq's Shia prime minister, is said to be reaching out to Sunni politicians, military men and tribal leaders in the hope of widening his narrow base in the Islamic Dawa party. But Iraq is entering an even more frenetic political phase than usual. The provincial elections should point, for the first time in three years, to whom the Iraqis want to run their country.

The poll will also serve as a dry run for a general election due at the end of next year. Moreover, under the tutelage of an energetic UN team in Baghdad, the system for the provincial elections provides for open lists, whereas last time they were closed. This time parties will win representation on a proportional basis in each of the 18 provinces (bar the three Kurdish ones and the disputed Kirkuk province, where elections will not take place), but voters will also be able to mark their order of preference for individual candidates on their chosen party list. Some 400-plus parties have been registered, more than 150 in Baghdad alone, with more than 14,600 candidates and 36-odd coalitions.

The main shift will be towards much stronger representation for Sunni Arabs, who have been sorely under-represented since Saddam's demise. A battle is brewing between the established Sunni parties and an array of groups emerging out of the tribal councils that have played so crucial a part in beating back the insurgency, including al-Qaeda, especially in the western province of Anbar and along the Euphrates valley north-west of Baghdad.

A fight for supremacy within the new Shia establishment has also begun. A striking development is the emergence of Mr Maliki as a would-be strongman. Despite his wooden persona on the dais and on television, he has surprised everyone by his increasingly ruthless determination to tighten his grip. He was boosted by his success, earlier this year, when he personally directed the Iraqi army to sweep the Shia militias loyal to Muqtada al-Sadr, a radical cleric, out of Iraq's then chaotic second city, Basra. The army promptly replicated that success in the hitherto lawless Shia slums of Baghdad, known as Sadr City. Mr Maliki is also interfering with senior appointments in the armed forces: the new divisional army commander in Mosul, for instance, is said to be a brother-in-law.

He has also gained ground, even among Sunnis, by his increasingly acerbic attitude towards the Kurds, who many Arabs think have overreached themselves in the past few years. In August he sent Iraqi army units into Khanaqin, a mainly Kurdish district that is controlled by the Kurdish authorities but falls within Diyala province. He and Massoud Barzani, president of the Kurdistan Regional Government, who heads the KDP, one of two rival parties that jointly run Iraqi Kurdistan, are increasingly rude to each other. Mr Barzani is said to have recently told Mr Maliki to his face: “You smell like a dictator.”

And he is rattling a lot of fellow Shias with his powers of patronage and purse. His own Dawa party has split, with his predecessor as prime minister, Ibrahim al-Jaafari, promoting himself as a stalking horse for the Sadrists, whose party has been barred from the lists. The other leading Shia party, the Islamic Supreme Council of Iraq, led by the ailing Abdel Aziz al-Hakim, is equally worried by what it sees as the prime minister’s authoritarian bent. In particular, Mr Maliki’s assorted rivals have complained about his setting up of “support councils” among various tribes, both Sunni and Shia, to help his party get out the vote—by means of bribery and intimidation, according to his detractors.

Competition among the Sunnis is no less fierce, especially in the tribal movement known as the *Sahwa* (Awakening) and the Salvation Front, which are bidding to oust candidates tied to the largest Sunni block in parliament, the National Accord Front, or *Tawafuq*, whose leading party is the IIP. Here too Mr Maliki has been weaving controversial alliances, backing one group against another. The political emergence of the tribes, many of which had previously supported the insurgents, is part of a new dynamic that has seen al-Qaeda and other rebel groups beaten back if not completely defeated. Mr Maliki has also been accused of having hundreds of IIP members arrested, especially in the mixed-sect Diyala province.

No one knows what the new electoral picture will be like. Some say that Mr Maliki’s Dawa will do badly, whatever the advantages of incumbency. The Sadrist movement, internally divided like so many others, is widely thought to have lost ground yet still commands the sympathy of hordes of poor Shias in such places as Sadr City and in the southern provinces. The tribal parties have never been tested.

Back to independence

Mr Maliki will naturally take as much credit as he can from the withdrawal agreement with the Americans. He, or so it will be claimed, has nailed down the occupiers and made them promise to leave within three years. Under the agreement, American forces, now about 146,000-strong in Iraq, will withdraw from the cities by the middle of next year. All military operations will require the assent of Iraqis. Americans will be barred from using Iraq as a launch pad to attack other countries.

There is, in fact, considerable wiggle-room in the agreement. The timing can be extended by mutual consent. Even the requirement for American troops to withdraw from city centres may be open to an elastic interpretation. The Joint Security Stations, where American troops are entrenched in mini-forts scattered across the cities, have been an essential part of the military surge which, since early last year, has stanched the terrible sectarian bloodletting, especially in Baghdad. Already they are jointly manned by Americans and Iraqis. Iraq’s generals may well be loth to remove the Americans, perhaps relabelling them as “advisers”.

The Iraqi army and national police (a kind of gendarmerie) have improved out of all recognition in the past two years and at last count numbered 266,000, alongside 257,000 local police, 36,000 border guards and more than 100,000 “Sons of Iraq”, the militias formed by the mainly Sunni tribal councils. But even their best units still rely heavily on the Americans for air support, not least the helicopters that are crucial in counter-insurgency, and for other technical skills, including communications, intelligence and logistics.

Despite the continuing horrors in Nineveh, bitter fighting in parts of Diyala, rising tension between Arabs and Kurds, and a continuing if less frequent cycle of bombs in Baghdad, the violence overall has greatly subsided from its level of two years ago. In the second half of 2006, violent civilian deaths, mostly in Baghdad, amounted to around 20,000, counted in morgues and hospitals. The latest estimates put the monthly figure at under 500 a month, still a shocking number, but an eighth of what it was. Fewer than 50 Iraqi soldiers and police were killed in October compared with 300-plus in April last year. The American military death toll has dived from 126 in May last year to 14 last month; the total since the invasion in 2003 is nearing 4,200.

But 20,000 out of Iraq’s 34,000 doctors have left (after 2,000 were murdered) and few of the 2m-plus Iraqis now living abroad (many of them middle-class professionals) are yet willing to return. In the past

few weeks, suicide-bombers have killed people at the checkpoints into Baghdad's international zone, on the road to the airport, by one of the main bridges and outside the Ministry of Trade, where eight female employees were killed. The country still offers nothing approaching a secure environment where foreigners can come and do business. A number of foreign companies, especially in the oil sector, have signed big deals. But no major foreign banks or businesses have thought it feasible to set up shop in the open in Baghdad. Though safer than it was, Baghdad is still the most dangerous capital in the world.

In any event, as the recently departed American mastermind of the surge, General David Petraeus, repeatedly said, the gains remain "fragile and reversible". The coming elections at the beginning and end of next year will give a vivid picture of Iraq's political balance of power. But a potentially devastating lack of consensus among the main political groups and their leaders still prevails. Corruption is rife. Many ministries are still fiefs of patronage. Family and tribal ties are what count in getting jobs. Intrigue and deceit seem to dog the management of just about every political party. No culture of tolerance or pluralism has yet emerged.

A fundamental three-way split still prevents Iraq from coming together as a country. Though it is hopeful that the Sunni Arabs, probably some 20% of the population, seem set to be drawn back into the heart of parliamentary and provincial politics next year, few of their leaders seem willing yet to acknowledge that they have lost the power that they had always held.

A former deputy prime minister, a Sunni, insisted last week that his fellow Sunnis represent "at least 50% of Iraqis, by God!" Some of the leading Shias, who by most calculations represent more than 50% of the total population, seem prepared to reach out to the Sunnis, especially the biddable tribal sheikhs, provided they accept their new position as second fiddlers. But most Shias still regard the Sunnis with suspicion. "Maliki's worst nightmare is still waking up to find a Sunni general in charge of the country again," says a seasoned Western observer in Baghdad.

No national harmony yet

The Kurds are enjoying a golden age of near-independence that they have never had before. Their region still feels the perkiest and safest in Iraq, though its leaders have yet to acquire truly democratic instincts. But the Kurds remain loth to make the sort of compromise over the bitterly disputed mixed Arab-Kurdish-Turkomen city of Kirkuk and the surrounding province which might in turn allow them to have more say over the oil in the area they control. Both Shia and Sunni Arabs habitually refer to the Kurds with ill-disguised contempt. American and UN diplomats fear that the Kurdish leaders, wary of being outflanked by each other on such issues as Kirkuk, are in danger of overplaying their hand—at a risk of losing much that they have already achieved.

In short, the new establishment of Shias, Sunnis and Kurds sorely needs to build a sense of nationhood. The withdrawal agreement means that it will soon be for the Iraqis alone to define their destiny. For the next few years the Americans may yet find themselves holding the ring. But once the occupiers have left, the chances that the Iraqis will entrench and cherish a stable, federal, pluralist democracy must still be rated at less than even.

Barack Obama's economic team

Off to work they go

Nov 27th 2008 | WASHINGTON, DC
From The Economist print edition

Barack Obama has stacked his cabinet with clever economists, but can they work together? And what will they do?

Reuters



WHEN *The Economist* asked academic economists in September which presidential candidate would pick the better economic team, a huge majority said Barack Obama. He has not disappointed them. The team he unveiled this past week is studded with stars of the profession.

Mr Obama's policies may not be any more successful at combating the financial crisis and recession than those of George Bush. But it does seem safe to say that economics will play a bigger part in the formation of those policies. Three of the first four members of the team to be named are well-regarded PhD-holding economists and the fourth, Tim Geithner, the new treasury secretary, is a respected central banker (he heads the Federal Reserve Bank of New York). Only one of the four people they will replace shares a comparable background (see chart).

The line-up

Barack Obama's economic team

	Outgoing	Incoming	Strengths and weaknesses*
Treasury secretary	Hank Paulson *Investment banker*	Tim Geithner *Central banker*	Hands-on crisis manager; limited experience in non-financial policy
National Economic Council director	Keith Hennessey *Congressional aide*	Larry Summers *Economist, ex-treasury secretary*	Brilliant, experienced; ego surplus, sensitivity deficit
Office of Management and Budget director	Jim Nussle *Congressman*	Peter Orszag *Economist*	Bipartisan respect in Congress; ability to say no is untested
Council of Economic Advisers chairman	Edward Lazear *Economist*	Christina Romer *Economist*	Leading economic historian; may be overshadowed by Summers
Economic Recovery Advisory Board chairman	none	Paul Volcker *Central banker*	Stature for slaying high inflation; new position overlaps with others

*Of incoming official

They are not just any economists but among the best. "Their IQs are off the chart," gushes a former colleague of some of them. Henry Kissinger supposedly once said every president should give Larry Summers an office in the White House. On November 24th Mr Obama did. As director of his National

Economic Council (NEC), Mr Summers “will be by my side, playing the critical role of co-ordinating my administration’s economic policy”.

It is a striking contrast with the outgoing administration, in which economists never had much clout. Consider the Office of Management and Budget director, who as overseer of $3 trillion in federal spending plays a pivotal role in setting economic priorities. Mr Bush has had four: one was a pharmaceuticals executive, one did government relations for an investment bank, and two were congressmen. All four trained as lawyers. Mr Obama’s nominee, Peter Orszag, the outgoing director of the non-partisan Congressional Budget Office, is a professional economist known for such page-turners as “Saving Social Security”, a 300-page tome boasting 37 pages of footnotes and eight appendices. Whether Mr Orszag will be tough enough with the red pencil, however, is something that his track-record does not tell us.

The team’s other striking feature is its centrism. Mr Summers is on the conservative wing of Democratic economists. As Mr Clinton’s treasury secretary he backed the law that in 1999 tore down barriers between commercial and investment banks and still backs it despite recent criticism. Christina Romer, an economic historian from Berkeley, has just published a paper with her husband David showing how raising taxes retards growth. Jason Furman, likely to be named as an aide to Mr Summers, outraged unions for his 2005 article, “Wal-Mart: A Progressive Success Story”. One hedge-fund manager who, before the election, was terrified Mr Obama would usher in “confiscatory” tax policies breathed a sigh of relief. “No Robert Reichs,” he said, a reference to the leftish adviser who was Mr Clinton’s labour secretary. “There’s no radicals in the whole cabinet that anyone can find.”

Mr Obama’s backers, in fact, can with some justification feel betrayed by the presence of so many figures from the Clinton regime: Mr Summers and Mr Geithner served at the Treasury then, and Mr Orszag was on the NEC. Moreover, many of them are protégés of Mr Clinton’s second treasury secretary, Robert Rubin, whose star has dimmed considerably as Citigroup, where he has been a senior executive since 1999, has lurched from crisis to catastrophe.

Still, if Mr Obama is going to emulate the economic record of any predecessors, Mr Clinton is not a bad one to pick. Hiring Mr Clinton’s team won’t bring back that era’s steady growth and low unemployment, but it does bring valuable experience of fighting financial crises. Mr Summers and Mr Geithner were deeply involved in dealing with the disasters that befell Mexico, East Asia, Russia and Latin America during that time. Mr Geithner has spent the past 15 months battling the current crisis, though so far with little success.

Their influence helps explain why Mr Obama wants a hefty fiscal stimulus to keep the economy from “falling into a deflationary spiral”. Mr Summers had prominently called for “significant, speedy and sustained” fiscal stimulus. Mr Obama says he has asked his team to come up with a two-year plan to raise employment by 2.5m more than would otherwise be the case. Reports suggest a price tag of $500 billion-$700 billion over two years. The stimulus could include both aid to states, funding for public infrastructure and early implementation of Mr Obama’s promised $1,000-per-family tax-credit. It may also include health-care aid for the poor and uninsured—a down payment on one of Mr Obama’s more costly promises.

Mr Obama’s people will also be more willing to deploy the $700 billion Troubled Asset Relief Programme to prop up the financial system; they may even seek to enlarge it, and pursue some formal powers for taking over failing financial institutions. Other issues they will have to tackle quickly include whether formally to guarantee the debts of the mortgage agencies, Fannie Mae and Freddie Mac; a moratorium on mortgage foreclosures; reform of bankruptcy law to permit judges to rewrite mortgage contracts; and reforming the financial regulatory system.

Though impressive enough on paper, it’s less clear how well Mr Obama’s picks will function as a team. The NEC director is traditionally the honest broker of the economic team’s ideas. Given his reputation as an intellectual bully, many wonder whether Mr Summers can play that role. “Larry clearly can’t do that, and it’s a waste of his talents, quite frankly,” says a former colleague. But that may sell Mr Summers short. More than anything else, he relishes a spirited debate with worthy adversaries. One of those is Mr Geithner, who first came to Mr Rubin’s attention by contradicting Mr Summers in a staff meeting. Mr Geithner once described the Rubin Treasury as “an open competition of ideas.” And Mr Summers will have no trouble standing up to Mr Obama’s skull-cracking chief of staff, Rahm Emanuel.

That said, too much competition of ideas can breed chaos, and Mr Obama may have increased the risk by creating yet another body. On November 26th he said Paul Volcker, a former Federal Reserve chairman, would head his new Economic Recovery Advisory Board and Austan Goolsbee, his longest-serving

economic adviser, would be its staff director. The board seems to overlap with the three-member Council of Economic Advisers, which vets policy proposals for economic idiocy: Mr Goolsbee will also serve on that council. Might too many economists spoil the recovery?

Masters of war

Nov 27th 2008 | WASHINGTON, DC
From The Economist print edition

Barack Obama's defence team is taking shape

ONE of Barack Obama's best moves so far has been a reported decision to do nothing—that is to keep Robert Gates on as secretary of defence.

Mr Gates has had an impressive record since taking over from Donald Rumsfeld in December 2006. He has presided over a dramatic improvement in the situation in Iraq, and restored morale in a badly demoralised department. At the same time, he has been commendably tough with underperforming subordinates, sacking both the secretary of the air force and his chief of staff over the lax handling of nuclear weapons. Keeping somebody with such a record makes sense at a time when America is embroiled in two wars, with improvements in Iraq still fragile and the situation in Afghanistan deteriorating.

Mr Gates's likely reappointment will allow Mr Obama to deliver on his promise to appoint at least one Republican in his cabinet. But in truth Mr Gates is an admirably non-partisan figure. He once worked in Jimmy Carter's NSC. He enjoys support on both sides of Capitol Hill. He has long shared Mr Obama's enthusiasm for engaging with Iran.

Mr Obama is edging closer to appointing the rest of his national security team, too, with Hillary Clinton as probable secretary of state (see Lexington) and James Jones as probable national security adviser. Mr Jones, a retired marine general who once served as NATO's supreme commander, will be the first former general to serve as national security adviser since Colin Powell did so in the Reagan White House in 1987-88. Like Mr Gates, he has a deep knowledge of military and intelligence affairs, broad bipartisan support and a streak of stubborn independence.

The only (minor) hitch in an otherwise ice-smooth transition has occurred at the CIA. John Brennan, a former CIA official who was in the running for the top job, withdrew his candidacy when liberal groups accused him of having supported the agency's use of "coercive interrogation techniques".

Mr Obama's national security appointments suggest a strong preference for pragmatism and flexibility. All three have supported positions more hawkish than his own. The American left is getting a rather different president from the war-opposing hopemonger that they voted for.

Bailing out the carmakers

A catalytic conversion

Nov 27th 2008 | WASHINGTON, DC
From The Economist print edition

The Big Three discover greenery on the road to Washington

EARLY next month, a caravan of cars will roll into central Washington. Representatives and associates of America's Big Three carmakers—GM, Ford and Chrysler—will drive a small fleet of fuel-efficient vehicles from Detroit to show Congress how the industry is greening. It will, ironically, use a lot of fuel: it is a 500-mile (800km) trip. But the aim is not to save petrol. It is to extract billions of dollars in loans from the federal government. A display of greenery, they hope, will be persuasive.

They have discovered what is not. Last week the Big Three's chief executives created a public-relations disaster by flying to Washington in private jets to beg Congress to lend them some money. They did not get it. The bosses argued that the government needed to step in to save 3m American jobs. The Democratic leadership was keen to lend over $25 billion from the recently passed Troubled Asset Relief Programme (TARP), but the Republicans, and even some Democrats, were sceptical from the start.

George Bush and his allies in Congress wanted instead to make it easier for the carmakers to draw on another $25 billion that Congress had already set aside to help the Big Three go green. Conservative Democrats such as Senator Claire McCaskill demanded guarantees that taxpayers' money would not be wasted. Lacking the necessary votes, Congress's leaders agreed that no help could be given without detailed restructuring plans.

GM and Chrysler, however, may not survive long enough to be bailed out, and Ford is burning through the billions, too. There is talk of "pre-packaging" bankruptcies over the next month, under which creditors, investors and related businesses would negotiate claims before any of the Big Three formally filed for bankruptcy. But GM claims that 80% of its customers would not buy a car from a bankrupt firm.

Louie Gohmert, a Republican congressman from Texas, wants a $1,500 tax credit for people who buy American-made cars. Other people think the Big Three should merge into the Big One, combining efforts to meet emissions standards and attracting government cash in the process. For their part, the Democratic leaders are still keen to approve some kind of loans. They want to do so in a second "lame-duck" session of the outgoing Congress after the companies submit their restructuring plans, supposedly on December 2nd.

Bloomberg

Congress may still balk at this. Many Republicans remain opposed to Detroit getting more cash under any circumstances. On the other side, plenty of Democrats worry about adding any strings at all: the leadership has been undemanding, imposing only a few conditions such as caps on executives' pay. Nancy Pelosi, the speaker of the House, has already rejected the Republicans' preferred option of using the not-yet-disbursed $25 billion green loan programme. Harry Reid, the Senate majority leader, argues that even if Congress does not pass anything, Mr Bush has the power to divert TARP funds to carmakers. The result is a game of chicken, with the Big Three caught in the middle.

Their position has clearly declined markedly in Washington, DC. John Dingell, a representative from Michigan and for decades one of the industry's most powerful allies on Capitol Hill, has just lost his perch as the chairman of the House Energy and Commerce Committee to Henry Waxman, a Californian environmentalist. Mr Waxman appears to have secured his new job with the quiet support of Ms Pelosi, a sign that the Democrats are serious about pushing through climate-change legislation. The Californian will be a powerful influence—his committee oversees health-care as well as much else, and one of his former aides

has just been chosen by Barack Obama to liaise with Congress. For Detroit, it is more bad news.



What's the opposite of hot cakes?

Barack Obama's BlackBerry

Subject: health care

Nov 27th 2008
From The Economist print edition

Another e-mail from the president-elect's inbox



"YOU finessed health care brilliantly during the campaign. You ran rings round Hillary on individual mandates, arguing it is unreasonable to require people to buy health insurance when its cost is unknown. You then made mincemeat out of John McCain's proposal to end the favourable tax treatment of employer-provided health insurance, insisting this would cost most people thousands of dollars. Yet somehow you convinced voters you would expand coverage and tackle costs without resorting to radical plans.

But now the campaign's over and it's time to get real. The good news is that you can still make health a top issue next year, despite the financial mess. The bad news is that to make any headway, you'll have to be ready to do a few U-turns.

Part of you is probably wondering if we should shelve health care for now. The short answer: no way, José, for two reasons. One is the economic crisis itself. As unemployment grows, millions will lose their health cover or live in fear of losing it. They will clamour for you to act. You should quickly increase the money given to states to pay for Medicaid and SCHIP (the scheme for children's health that W. hates so much). You can deflect sceptics by arguing that increased spending on health (which can't be made in China) will do more to stimulate the economy than issuing tax refunds (which consumers will only squirrel away under their mattresses).

The second reason not to hide from this issue is Congress. Momentum is building even among Republicans to act soon, and Teddy Kennedy is back fighting for it. One problem though is the Senate Finance Committee. Max Baucus, its chairman, has just released his own health reform plan, which calls for both individual mandates and reform of the tax break for employer-provided health coverage. You need to show Baucus some love—or, better yet, to take his reform proposals seriously.

You might be tempted to go slow, with incremental reforms—say, tackling costs through investments in health information technology. But the coalition for more ambitious reform is growing stronger. Soaring

costs have led big business to support universal coverage, while the middle class knows employer-provided health insurance is no longer reliable. The big health insurers have even agreed to cover everyone with pre-existing conditions—but only if we impose an individual mandate.

The bottom line is this: if we are really going to go for serious reform that tackles both cost and coverage, you are going to have to change your positions on the distortionary tax break for employer-provided coverage and on individual mandates. You can soften the first U-turn by initially only ruling out the most expensive tax deductions; and you can hide the retreat on mandates in a grand presidential compromise. But we can do this. As Rahm Emanuel loves to say, we should never allow a crisis to go to waste."




The death penalty

Reasonable doubt

Nov 27th 2008
From The Economist print edition

Troubling questions surround a capital case in Georgia

IN 1989 Troy Davis and two friends were hanging out in Savannah, Georgia. They saw a homeless man leaving a shop and started to bully him. An off-duty policeman heard the commotion and intervened; he was shot and killed. Though no gun was found, the state produced nine witnesses who said that Mr Davis was the culprit. He was convicted of the murder and sentenced to death in 1991.

It seemed a straightforward case. Americans particularly revile cop-killers and here was a parade of people saying that Mr Davis had shot a policeman. But after the trial, no fewer than seven of the nine recanted. Several of them said they had felt subjected to pressure by the police. Others thought someone else was the killer. The homeless man said he could not remember, and anyway he had been drinking.

This was hardly the clear-cut result a state wants to have when it is handing down a death sentence, and legal wrangling has been going on ever since 1991 in state and circuit courts. Much of the debate is over procedure: judges who have ruled against Mr Davis's various appeals argue that you need lots of new evidence to revisit a case, not a gaggle of shifty witnesses.

The result is a hideous mess. An execution date was set for July 2007. The day before the sentence was to be carried out, the state issued a stay. In March 2008 Georgia's Supreme Court ruled that Mr Davis should not get a new trial and another execution date was set. On September 23rd Mr Davis was again awaiting death. The prison prepared a last meal of macaroni, cornbread and salad, but he turned it down. The reprieve came with less than two hours to go: the United States Supreme Court had granted a stay. Three weeks later, the court decided not to hear Mr Davis's case. A third execution date was set for October. Three days before it arrived, yet another stay was granted. On December 9th the circuit court will consider whether Mr Davis can continue with his appeal or whether he has to die.

Even people who support the death penalty are crying foul. William Sessions, a former head of the FBI, says that because there was no physical evidence in the case, Mr Davis deserves another day in court. He may have killed a policeman, but Georgia needs to do more to prove it.



North Carolina

Watching and waiting

Nov 27th 2008 | CHARLOTTE
From The Economist print edition

America's second-biggest banking city comes to terms with the crisis

AT A car show in Charlotte, North Carolina, a young man sneered at a subcompact Chevrolet Aveo. "You ain't gonna catch a man driving that," he observed to his girlfriend. Perhaps not, but that view is becoming less popular. This year's "auto expos" are all about thrift and prudence, and the Charlotte show was no exception. Sports-utility vehicles sat sealed and silent. An elderly couple clambered into a hybrid sedan. A sceptical crowd circled the Ford Airstream, a concept car in groovy chrome and fluorescent orange. A child wondered if it could fly. No one was itching to buy it; they thought it was too ugly. But then few people were looking to buy any cars this year.

It has been a turbulent autumn for Charlotte, North Carolina's largest city and America's second-biggest banking centre after New York. Until last month the city's economy was anchored by Bank of America, on one side of Trade Street, and Wachovia, on the other. In September Bank of America swallowed up Merrill Lynch and is still trying to digest it. Wachovia contemplated buying Morgan Stanley, but its fortunes changed abruptly. In October, facing its own cash crunch and having nearly been sold to Citigroup, Wachovia itself was taken over by Wells Fargo.

Now the city is blanketed with uncertainty. Wachovia and Bank of America are the second- and third-biggest employers in the area (after the Carolinas Healthcare System), with 20,000 workers at the former and 14,000 at the latter. Bank of America cut several thousand jobs nationwide in 2008 and Kenneth Lewis, the chief executive, surprised no one when he predicted that 2009 would be another tough year. As for the Wachovia side of the street, Wells Fargo has said that Charlotte will remain its eastern headquarters; but beyond that the situation is in limbo.

It is an unwelcome reverse for a city that has spent the past few decades quietly enjoying growth and prosperity. Mecklenburg County, which encompasses Charlotte and its main suburbs, has swollen from 400,000 people in 1980 to 900,000 today. The migration is largely from northern cities like Buffalo, Pittsburgh, or Cleveland. People came for the robust job market and stayed for the easy living.

And city leaders made some wise moves during the good years. Pat McCrory, in his seventh term as mayor, says that 12 years ago the downtown business district was dead after office hours. Today more than 10,000 people live there, and at night it is a jolly tangle of steakhouses and sports bars. A public transport plan that was first approved in 1998 survived a last-minute repeal effort last year. The light rail opened in November 2007 and it has been a cracking success, especially after hurricanes this summer caused a petrol shortage in the south-east. Planners had hoped for 9,000 riders a day by this point; they already have 16,000.

Harrison Campbell, a professor of economic geography at the University of North Carolina at Charlotte, reckons that the city is in for a bump in the road. But he says that the economy is more diversified than people realise, and that the new amenities will help cushion the blow, because the city has become more appealing to young professionals. At a Beaujolais Nouveau tasting at the Levine Museum of the New South, one newcomer allowed that Charlotte was quieter than his previous Chicago home, but said that he is happy to be there. He enjoys a side career as a voice-over artist.

Such stories are common enough in Charlotte. And the experts are relatively sanguine about Charlotte's economy. Unemployment is up in Mecklenburg County: 6.6% in September, up from 5.1% in January, but the county has actually added jobs over that time; the labour force is growing. And home prices in the metro area were down 3.5% in September compared with the previous year—not good, but a small drop compared with many areas.

"It's crappy," admits Tony Crumbley, the head of research for the chamber of commerce. "However, it's a lot better here than it is in most places." Just the other day, he noted, a seafood supplier had closed. The

connection between fish and banks is not immediately obvious, but it turns out that Wachovia was their largest purchaser. “If I was one of the 200 people working for Poseidon I’d be very depressed right now,” said Mr Crumbley. “But I dare say it’s not like Detroit or Indiana.”

Migrant labour

Tough times

Nov 27th 2008 | MIAMI
From The Economist print edition

Hispanic labour is feeling the pinch

CARLOS PIRIR used to earn a good salary as a construction worker on a high-rise building site in downtown Miami. Now the Guatemalan immigrant spends his mornings competing for a day's work, standing by the side of the road outside a hardware store in a working class district of Miami. "Before, there was work and the pay was good. Now it's all paralysed," he says.

Latinos are among the hardest hit by the economic downturn in America. The unemployment rate among all Hispanics rose to 8.8% in October, according to government figures, well above the national unemployment rate of 6.5%. It is expected to be worse still for Hispanic immigrants, whose unemployment rate already stood at 7.5% in the first quarter of this year; though their numbers are declining fast. The Mexican government said last week that the number of its citizens who left to live abroad this year was down more than 40% compared with 2006, and America's Border Patrol says it caught 18% fewer people in the fiscal year that ended in September than in the one before.

"They are really between a rock and a hard place. The economy sours and there's no safety net for them back home," says Brent Wilkes, director of the League of United Latin American Citizens (LULAC).

Money-transfer companies are reporting a dramatic fall in remittances by migrant communities. The growth in cash sent home from America had already slowed in 2007 to the lowest rate since 2000 according to the Inter-American Development Bank. Remittances to Mexico specifically have increased rapidly in recent years, rising by 17% in 2006 to $23.7 billion, but they grew by just 1% last year. Mexico's central bank now says that it expects a decline in remittances of 7-8% this year.

Mr Pirir used to send $600 a month to his wife and seven children back home. Last month he managed only $200. The immigrant labour crunch has been especially severe in the south Florida construction industry. Immigrant workers were highly sought after during the region's building boom, earning up to $1,000 a week on busy construction sites. At its peak in 2006 the building boom employed more than 165,000 workers in south Florida alone. But 30,000 of those jobs have gone, according to the Department of Labour, and that number is expected to rise as new construction grinds to a halt. Over 20% of Mexican migrants in America work in construction, according to Mexico's central bank.

The effect is beginning to be felt in Mexico too, especially in communities most dependent on remittances. Besides a lack of jobs, there has also been a concerted crack down on undocumented workers by American immigration officials. And with the American economy now in recession, things are only going to get worse. Mr Pirir, for one, says he's had enough. He's saving money to pay for the journey home.

Hunting in New England

Blood lust on the wane

Nov 27th 2008 | FRANCONIA, NEW HAMPSHIRE
From The Economist print edition

The sport is disappearing in its American birthplace

THE dense woods of northern New England are crackling these chilly November days with the sound of rifle shots: the deer-hunting season opened in mid-month and is in full swing. But the camouflaged shooters are not roaming the forests quite as they did in the past. In (non-native) America's oldest hunting grounds, the sport is in slow decline.

In Vermont the number of hunting licences sold has dropped 12% over the past ten years. In New Hampshire, where 60,000 resident and visiting hunters contribute $83m annually to the small state's economy, the decline is even steeper: a 28% drop in licences since 1996.

The ceasefire causes problems, since the fees are used to help pay for wildlife management. Judy Stokes, of New Hampshire's Department of Fish and Game, identifies several causes: the loss of hunting areas to housing and commercial development; the competing demands on family time posed by sport and other weekend activities for children; and a changing social structure. "It takes a hunter to make a hunter, and fewer fathers are bringing up their children as hunters," she says.

Of New England's northern states, only Maine has seen the popularity of hunting hold steady. The number of licences issued there has stayed at about 200,000 since 1993. Paul Jacques, of the state wildlife department, thinks this is because Maine is better than its neighbours at keeping game and fish populations high for hunters and anglers. The state has also encouraged both young and old to join the hunt. It has introduced a $500 lifetime licence for children under 16, and Maine citizens aged 70 years and older can buy a lifetime licence for $8.

Maine has a special incentive to protect its outdoors. Its gross state product is less than $50 billion, and the contribution of hunting, fishing, bird-watching, boating and so on is put at $2.5 billion—a vital statistic in a state where L.L. Bean, an outdoors catalogue company, ranks among the five largest employers.

Lexington

Head of State

Nov 27th 2008
From The Economist print edition

The Obama-Clinton soap opera is set to run for another few years

Illustration by KAL



AT THE height of the recent Democratic civil war, Samantha Power, an Obama adviser and a student of genocide, told a Scottish newspaper that Hillary Clinton was a “monster”. Ms Power had no choice but to resign. But she was only giving voice to what most Obamaites happily said in private.

Mr Obama’s apparent decision to offer the job of secretary of state to his old rival has inevitably caused a furore. There is a long tradition, going back to John Quincy Adams and Henry Clay, of treating “State” as a consolation prize. But Americans are nonetheless obsessed by divining the meaning of the choice. Is Mr Obama kissing Mrs Clinton’s ring? Or is he trussing her up in a golden straitjacket? They are equally obsessed by deciding whether it will work or not. Will the Clintons undermine Mr Obama’s administration? Or will they complement it? Is this, in short, a marriage made in heaven or in hell?

Many hard-core Obama supporters are furious about the decision to embrace the “monster”. They did not spend two years of their life working for “hope” and “change” only to see the Clintons and their various incubuses and succubuses restored to power. The man who promised to transform Washington is doing nothing more than turning the clock back to the 1990s.

A lot of old Washington hands are also dubious about the decision. Thomas Friedman, a *New York Times* columnist, argues that, if they want to have a successful foreign policy, presidents need to have a close personal bond with their secretaries of state: witness Richard Nixon and Henry Kissinger or George Bush senior and James Baker. There can be no such bond between former (and perhaps future) rivals, particularly when they have such marked differences of generation and style.

David Broder, of the *Washington Post*, worries that Mrs Clinton will escape from Mr Obama’s straitjacket and try to fashion an independent foreign policy (“He needs an agent, not an author”). Old foreign-policy hands argue that it is foolish to appoint somebody you cannot sack. And everyone worries about Bill Clinton. Will his global junketing create conflicts of interest? Will he be able to resist giving his advice to his wife—or to stray journalists? What happens if team Clinton and team Obama disagree over what to do when that 3am call comes in?

There are certainly reasons for caution. Mrs Clinton has surely not given up her ambition to become the

second President Clinton. Mr Clinton has made millions for both himself and his foundation from the global lecture-and-advice circuit. The Clinton Foundation has a staff of 800 who deal with sensitive issues such as AIDS and poverty reduction. All sitting presidents are rightly leery of giving their predecessors a chance to interfere in foreign policy. The media beast will undoubtedly seize on any signs of discord between the two Democratic families.

But the case against the appointment is nevertheless exaggerated. Mr Obama and Mrs Clinton have remarkably few ideological differences: they are both pragmatists who believe in working through diplomacy if possible but in resorting unhesitatingly to force if necessary. Their squabbles during the primaries—over Mrs Clinton's vote to authorise the Iraq war or Mr Obama's willingness to hold "unconditional" talks with Iran—were mainly squabbles over details, not substance. There is nothing comparable here to the profoundly damaging philosophical differences in the first Bush administration between the doves, led by Colin Powell, and the hawks, led by Dick Cheney.

Politicians do not need ideological differences to get into a fight, to be sure. Even in the best of times the State Department has a long history of fighting turf wars with other instruments of foreign-policy making, particularly the Pentagon, the National Security Council, the vice-president's office and the Oval Office. Won't the arrival of a prima donna at Foggy Bottom make these turf wars even worse than usual?

Not necessarily. Joe Biden, who has plenty to say about foreign policy, was reportedly one of Mrs Clinton's leading backers for the job. Robert Gates, who seems to be staying on as defence secretary, has been arguing for years that America has invested too much in the Pentagon at the expense of the State Department. Mrs Clinton has a long-standing relationship with James Jones, the former general and NATO commander whom Mr Obama is said to have tapped as national security adviser (though whether the relationship will survive the traditional rivalry between that role and the secretary of state is another matter).

Star power, and more

Mrs Clinton will also bring an impressive list of qualities to Foggy Bottom. One is star power. The former first lady and erstwhile presidential candidate will have no trouble attracting attention wherever she goes. Another is knowledge. Mrs Clinton has a unique combination of experience of both America's soft power and its hard power: as first lady she visited 80 countries, and as a member of the Senate Armed Services Committee, she oversaw the American military machine. And Mrs Clinton will be as well placed as any secretary of state for a generation to make progress in the Middle East: she knows most of the main characters personally, she sees eye to eye with Mr Obama, she can draw on her husband's legacy and she is nothing if not relentless. Defeat and humiliation only seem to make her stronger—the perfect qualification for dealing with the Middle East.

The next president will face daunting foreign-policy tasks as well as a mother-in-law of a recession. America's global brand has been tarnished. The battle with radical Islam has been turned into a partisan issue. The machinery of policymaking has been wrenched out of shape, particularly at the State Department. Sending a big beast like Mrs Clinton over to the State Department is undoubtedly risky. But sending a small beast to do such a big job might be riskier still.



Latin American diplomacy

Friends of opportunity

Nov 27th 2008
From The Economist print edition

China, rather than Russia, is the new partner that matters

AFP

FOR those who think a new cold war has broken out, this week seemed to provide some evidence. The *Peter the Great*, a nuclear-powered cruiser, and two other Russian warships, arrived in the Caribbean to exercise with the Venezuelan navy. Onshore, Russia's president, Dmitry Medvedev, met Venezuela's Hugo Chávez as part of a Latin American tour. In Peru, he attended the APEC summit, a get-together of leaders from 21 Asian and Pacific countries. Like Mr Medvedev, China's Hu Jintao (pictured with Peru's president, Alan García) also used the Lima meeting as a pretext for a Latin American tour, which in his case took in Costa Rica and Cuba. Last year another visitor from far-flung parts, Iran's Mahmoud Ahmadinejad, turned up in Latin America.

To some in the United States, this flurry of outside interest in a region that they considered their "backyard" is threatening. They see it is a sign that under President George Bush America has lost influence in the region. In fact, Latin America's international ties have long been more diverse than caricature allows, but they are becoming even more so as the world changes. For some South American countries, Europe has always been at least as important as a trade and investment partner as the United States. Trade with Japan and the Middle East grew in the 1970s, while the Soviet Union sold arms to Peru as well as sustaining communist Cuba.

It is Mr Chávez's search for allies in his rhetorical and political battle against the "empire", as he likes to call the United States, that pricked the interest of Russia and Iran. For Russia, its Caribbean naval jaunt is a symbolic riposte to America's plan to place missile batteries in Poland and to its dispatch of naval vessels to distribute aid in Georgia after Russia's incursion in August. The same goes for its recent revival of ties with Cuba.

But Mr Medvedev's main purpose in Latin America is business. Mr Chávez has already bought arms worth $4.4 billion from Russia—including a Kalashnikov factory due to start producing 50,000 rifles a year in 2010. Russia was reported this month to have signed a contract to sell Venezuela portable air-defence missiles. That would alarm Colombian officials, who will fear their onward unofficial sale to the FARC guerrillas. Russian oil, gas and mining companies have signed deals to invest in Venezuela. Mr Chávez would like the Russians to build a nuclear power station.

Mr Medvedev arrived in Caracas from Brasília. Brazil is close to signing an arms deal with France, which has agreed to pass on jet-fighter technology. But it may buy Russian helicopters, and sees scope for collaboration with Russia on civilian nuclear technology and aerospace. Mr Medvedev said in Rio de Janeiro that he hoped trade between the two countries would soon double from last year's $5 billion. Russian companies are interested in extracting Brazilian oil too. After initially embracing Mr Chávez as an ally, Brazil's government has recently sought quietly to neutralise his influence. By inviting Mr Medvedev Brazil's message to Russia is: "if you want to have a significant relationship in South America, have it with us," says Paulo Sotero, a Brazil specialist at the Woodrow Wilson Center, a think-tank in Washington, DC.

The motive for Iran's recent interest in Latin America seems to be a desire to add to its small stock of diplomatic friends around the world, and to score propaganda points against the United States. Mr Chávez has signed no fewer than 200 co-operation agreements with Iran. Venezuelan officials say that Iran has invested more than $7 billion in their country—in plants to assemble cars, tractors, farm machinery and bicycles, as well as oil—and that bilateral trade has reached $4.6 billion. But these figures may be exaggerated. Last year *Ultimas Noticias*, a pro-government newspaper, reported big delays on some Iranian investments and rake-offs by local officials involved in them.

In Mr Chávez's wake, socialist presidents in Bolivia, Ecuador and Nicaragua have also developed ties with Iran. Mr Ahmadinejad promised investments of $1.1 billion in developing Bolivia's gas, and $350m to build a port in Nicaragua. But there is little sign of either investment materialising. Brazil's foreign minister, Celso Amorim, recently visited Tehran and delivered a letter from President Luiz Inácio Lula da Silva inviting Mr Ahmadinejad to visit. Since Iran is the subject of United Nations sanctions, and Brazil has been actively, if fruitlessly, pursuing a permanent seat at the UN, this raised eyebrows in Brazil. Mr Amorim's visit was "inexplicable" and "gratuitous", according to Luiz Felipe Lampreia, a former foreign minister.

The intercontinental ambitions of Iran, Russia and Venezuela have all been puffed up by oil, and so are vulnerable to the steep fall in its price. The lasting change for Latin America is its burgeoning ties with China. At the APEC summit, Mr Bush's last trip abroad, it was Mr Hu who was the centre of attention. Mr García treated him to a parade around Lima's colonial centre before they announced that they had wrapped up a free-trade agreement between their two countries. That matches a similar accord China concluded with Chile in 2005.

China's total two-way trade with Latin America has shot up from just $12.2 billion in 2000 to $102 billion last year. Though Chinese investment—mainly in mining and oil—has grown more slowly, it is now picking up. Last month China became a member of the Inter-American Development Bank. But China has also disappointed some Latin Americans. Some Brazilians complain that Brazil sells raw materials to China while buying manufactures from it. Brazil is frustrated that neither China nor Russia has helped its Security Council bid.

All Latin American countries are naturally keen to diversify their economic relations, and some seek wider political ties. But Europe ($250 billion last year) and the United States ($560 billion) remain Latin America's biggest trade partners. And the foreign leader that most Latin American politicians will be keenest to see over the coming year is Barack Obama.



Venezuela's regional elections

Checked, but not halted

Nov 27th 2008 | CARACAS
From The Economist print edition

Some satisfaction for Hugo Chávez but more for his opponents

RARELY can a round of regional elections have been presented in such an apocalyptic fashion. Hugo Chávez, Venezuela's president, told his followers during the campaign that if the opposition won the capital, Caracas, and the populous states around it in the poll on November 23rd, then 2009 would be "a year of war" with his foes seeking to overthrow him. In the event that is more or less what the opposition achieved. But the victors immediately offered to work with the government.

AP



No socialism for them

Overall, the results allowed Mr Chávez, Latin America's most controversial leader, to present the election as a triumph for his United Socialist Party of Venezuela (PSUV). Pointing out that 17 of the 22 states, and most municipalities, had remained in government hands, he proclaimed that "the path towards the construction of Bolivarian socialism" had been ratified. But many of the PSUV victories were in sparsely populated rural areas. The opposition won where it mattered most. It prevailed in the three most populous states—Zulia, Miranda and Carabobo—together with metropolitan Caracas and four of the capital's five districts.

Mr Chávez had gone to extraordinary lengths to weaken the opposition's chances. The government disqualified the opposition's most popular candidates for Caracas and Miranda. It spent vast amounts of public money on propaganda for the PSUV. Mr Chávez made crude threats of retribution, saying that he "might end up having to bring out the tanks" if the opposition won Carabobo.

But this bluster seemed to backfire. In 2004, when local and regional elections were last held, the opposition was battered by a bruising failure to unseat the president in a mid-term recall referendum. Having called (without evidence) that result a fraud, the opposition gave its supporters little incentive to vote in the regional ballot, and it won only in Zulia and the small state of Nueva Esparta. Now it has returned in style to the heart of the country.

In doing so, it has trounced two of Mr Chávez's senior lieutenants and proved that it is capable of defeating the "revolution" even in poor urban barrios. The victory of Carlos Ocariz, of the centre-right Justice First party, in the sprawling slums of eastern Caracas, is particularly painful for a government that claims to be fighting a class war on behalf of the poor. By favouring the opposition, urban voters showed that they were worried by the rampant crime, inflation and poor administration that are starting to eclipse generous oil-financed social programmes as the hallmarks of Mr Chávez's rule.

Even so, the result was hardly an unalloyed triumph for the opposition. Though more united than in the past, it improved only slightly on the two-fifths share of the vote that has been its ceiling over the past decade, winning 42%. It was the emergence of dissidents in the *chavista* camp that helped to cut the president's habitual vote of some 60% by around seven percentage points. Mr Chávez remains Venezuela's most popular politician. But having deliberately turned the vote into a polarising plebiscite on his rule, resulting in a record turnout for a regional election of 65%, the president has more cause for concern at the result than his opponents.

A year ago Mr Chávez's attempt to introduce a new "socialist" constitution that would have allowed indefinite presidential re-election was narrowly defeated in a referendum. This week he said he would not personally seek again to remove the constitutional bar on more than two terms. This will force him to leave power in January 2013. "What I can't avoid," he added disingenuously, "is someone else doing it." But his chances of success in any repeat of the constitutional referendum look weaker in the light of the election result. Opinion polls suggest re-election is unpopular even among some *chavistas*.



For now Mr Chávez retains a firm grip on political power. He has no substantial challengers within his party. But he is no longer the invincible vote-winner he once was. Dissenters within the ranks of the revolution—"traitors", he calls them—challenged his candidates in several states. His own brother, Adán, had a tough time winning the family's home state of Barinas, where a dissident candidate, Julio César Reyes, is refusing to accept the result. The dissidents include members of two small left-wing parties which refused to dissolve themselves into the PSUV when Mr Chávez set it up last year. He seemed to be even more concerned to crush them than to defeat the opposition.

The threat to Mr Chávez next year is not civil war, as he suggested. It is mounting economic pain prompted by the fall in the price of oil, Venezuela's sole significant source of income. The government has a cushion of reserves of uncertain size, but is otherwise ill-equipped to cope with a downturn. "Ten years of inefficiency, of permanent conflict, of corruption, are taking effect," says Teodoro Petkoff, the editor of a centre-left opposition newspaper.

The opposition still lacks a convincing programme and a popular national leader. Mr Ocariz, or the new Caracas mayor, Antonio Ledezma, or Miranda's governor, Henrique Capriles, now have the chance to audition for the role. It will not be easy. Neglect means that Caracas will be tough to govern. Mr Chávez has threatened to starve opposition governors of funds, and to undermine them by setting up parallel bodies appointed by himself. But if he fails to notice that urban Venezuelans are calling for change, his future looks bleak.

Argentina

Harvesting pensions

Nov 27th 2008 | BUENOS AIRES
From The Economist print edition

A pre-election boost for Cristina

Reuters



Minding about the pension gap

JUST four months ago, opponents of Argentina's government seemed to have the president, Cristina Fernández de Kirchner, on the ropes. They secured the support of legislators from the ruling Peronist movement to defeat an unpopular bill to increase taxes on farm exports. But now Ms Fernández has found another, far more popular, way to raise funds. A law to nationalise the country's private pension system was approved by Congress on November 20th, having won the support of some 70% of both houses, including many in the opposition.

That vote reflects the widespread unpopularity of the private pension funds, which charged stiff management fees, and whose returns were depressed by being bullied into investing 55% of their assets in public debt. The government claims the nationalisation is to defend future pensioners. But if so, it could merely have reopened a scheme to allow pensioners to return to the state system (only 12% did when given the option last year).

Many economists see the measure as a naked government grab for pensioners' assets. In the month after it was announced on October 20th, the Buenos Aires stockmarket index fell by 27%, and $4 billion fled the country. Even ordinary Argentines got the jitters, pulling 5% of their deposits out of banks. Businessmen worry that the government, now the owner of shares equivalent to 13% of Argentina's stockmarket, will seek to place interventionist directors on the boards of private companies.

The government faces a financial squeeze. It must repay $23 billion of expiring bonds over the next two years that it cannot roll over because investors fear Argentina may be heading for another debt default and are demanding a prohibitive interest rate. Revenues from taxes on farm exports, the government's cash cow, have fallen by a third because of lower world prices for foodstuffs. Having grown by 8% a year for five years, the economy is now slowing sharply.

The pension nationalisation puts the state in charge of assets totalling $23 billion, rising by $4.5 billion a year in new contributions. Ms Fernández now plans to spend a chunk of them. On November 25th she announced a plan to channel some of the funds into a $21 billion public-works programme aimed at keeping economic growth at over 4% next year.

If this works it should help Ms Fernández to shore up support among local politicians and the voters before a mid-term election next October. Those in the opposition who backed the pension nationalisation may come to regret it. And future pensioners may find their money has disappeared into holes in the ground.

Ecuador

Can pay, might not

Nov 27th 2008 | QUITO
From The Economist print edition

Another debt default?

ACCORDING to Rafael Correa, Ecuador's president, one of the benefits of the world financial crisis has been an end to annoying visits by "yuppies" from ratings agencies and investment banks holding Ecuadorean debt. Mr Correa seems keen to do without such inconveniences altogether.

On November 15th his government delayed a $30.6m interest payment on part of its foreign debt of $10 billion. Five days later it released the report of a committee it set up to audit all of the country's debt contracts between 1976 and 2006. The committee says it found widespread evidence of malfeasance, particularly in three sets of bonds with a total value of $3.9 billion. "Horrifying", said Mr Correa. Some of his supporters want former presidents who signed the debt agreements to be jailed. They also want the government not to pay the debt.

Some of Mr Correa's opponents have denounced the audit as ideologically driven and as erecting a conspiracy theory. Ecuador has twice defaulted on its debt since 1982, on each occasion when its economy collapsed. It is hardly as if the government cannot pay now. The public debt amounts to only 21% of GDP, and until recently the government was flush with oil revenues.

Mr Correa, who calls himself a Christian Socialist, claims to be defending a principle. He has said that Ecuador will default only if it concludes that it could win subsequent lawsuits against bondholders. That looks unlikely. So one theory is that the whole exercise is aimed at driving down the value of the questioned bonds—they now trade at less than a third of face value—so the government can either buy them back or force a debt renegotiation. Ricardo Patiño, a former finance minister who took part in the audit, suggested that investors should accept a write-down of more than 60% in the bonds' value.

By discouraging private investment Mr Correa is making Ecuador more dependent on oil, both for foreign exchange and government revenue. Unless the oil price climbs again, the fiscal deficit could reach 5% of GDP next year, according to Analytica Investments, a securities trader. That is because Mr Correa has ramped up social spending and subsidies. Some of that spending may be justified. But forcing foreign creditors to pay for it looks short-sighted.



WORLD
ASIA

Terror in Mumbai

India under attack

Nov 27th 2008 | MUMBAI
From The Economist print edition

A terrorist onslaught of stunning scope and horror

Reuters



Correction to this article

THE sheer scale and audacity of the assault were staggering. Gangs of well-armed youths attacked two luxury hotels, a restaurant, a railway station and at least one hospital. Gunfire and explosions rang through Mumbai overnight on November 26th-27th and through the next morning. As *The Economist* went to press, more than 100 people were reported to have been killed, and the toll seemed likely to rise. Several foreigners, including some from America, Japan and Britain, were among the dead. So were over a dozen policemen, including Mumbai's chief counter-terrorism officer. Up to 100 hostages, including selected American and British guests, were alleged to be held hostage inside a hotel.

Even in a city—and country—with a grim record of terrorist violence, these were extraordinary scenes. The attacks started at around 10.30pm on November 26th, when gunmen started shooting and throwing grenades at Mumbai's main Chhatrapati Shivaji Terminus railway station. Television footage showed two men shooting at random as they drove through nearby streets in a stolen police jeep.

Around the same time, a bomb was reported to have exploded in a taxi parked near the city's main airport. More or less simultaneously, gunmen speaking Hindi and Urdu, the language of many north-Indian Muslims and of neighbouring Pakistan, stormed two hotels—the Taj Mahal and the Trident Oberoi—and Café Leopold, a restaurant popular with tourists. Police outside the Taj Mahal, India's most famous hotel, lapped by the Arabian Sea, said gunmen arrived there by inflatable dinghy. In the early hours, a gunfight erupted on Marine Drive, the scenic coastal road seen in so many Bollywood films, in which another Mumbai police chief was killed.

As dawn broke, flames were rising from the domed roof of the Taj Mahal. Navy and army commandos, who had retaken the hotel's lower floors and killed two terrorists, reported bodies in many rooms and perhaps half a dozen terrorists still living. A trickle of terrified employees and guests, some with gunshot wounds, continued to flee the building. One fugitive, Amit, a hotel-restaurant manager, said his chef had been hit by three bullets and many colleagues remained inside. A few badly injured survivors were wheeled from the hotel on brass luggage-trolleys. By midday on November 27th most of the hostages were reported to have been released from the hotel, although there were reports of further shooting.

Meanwhile at the nearby Trident Oberoi, as many as 100 hostages were reported still to be held. Gunfire and explosions were reported from the upper storeys of the building.

There seemed little doubt that the attackers were Muslim militants of some description, but their exact

provenance was unclear. Responsibility was claimed by a previously little-known group called the Deccan Mujahideen. Speaking to Indian television by telephone, a gunman holding hostages in the Trident Oberoi demanded that Muslim prisoners, including those captured in Kashmir, should be released from Indian jails. "Release all the mujahideens, and Muslims living in India should not be troubled," he said.

In the past five months India has suffered from a spate of Islamist militancy, with bomb-blasts in half a dozen cities, including Delhi, Bangalore and Jaipur. A home-grown Muslim terrorist group, the Indian Mujahideen, has been blamed for the spree, in which over 150 people were killed. In a chilling, 14-page admission of responsibility for the Delhi bombings in September, the Indian Mujahideen castigated the counter-terrorism efforts of Mumbai's police, and promised Mumbaikars future "deadly attacks".

As India's first indigenous Muslim terrorist group—so they have often been described—the Indian Mujahideen are a worrying sign. They seem to have evolved from a decade-long campaign by Pakistan-based militants, including many fighting an insurgency in Kashmir, to incite India's 150m Muslims to revolt. These groups have been held primarily responsible for half a dozen major terrorist attacks in Mumbai in recent years. In 1993 local Muslim gangsters backed by Pakistan-based militants set off 13 near-simultaneous bomb-blasts in the city, killing more than 250 people. In 2006 another co-ordinated bombing spree on Mumbai's railway killed over 180 commuters. A Pakistan-based group, Lashkar-e-Toiba, was blamed at the time.

This week's attacks in Mumbai seemed different, however. Attacks by bands of gunmen on numerous targets, instead of the mere laying of bombs, and the seizure of so many hostages, led to speculation, unsupported by evidence, that local militants in India could not have mounted the attacks without considerable foreign help. And the targets chosen—world-famous hotels and Western tourists—were a new phenomenon for India, despite being a pattern familiar from attacks directed or inspired by al-Qaeda elsewhere in the world.

Al-Qaeda has often threatened to launch strikes in India. In 2006 Arab terrorists belonging to the organisation were foiled in an attempt to set off bombs in Goa, India's main destination for foreign tourists. Among the targets of the latest attacks was a Jewish religious centre in southern Mumbai which was reported to have been fired on by the gunmen. Police said that an Israeli rabbi and his family were among a group being held as hostages in a nearby apartment block.

Despite these worrying signs, Indian officials have so far resisted suggestions that Indian Muslims are being radicalised and joining a global *jihad*. Many refer approvingly to the observation of George Bush that Muslims from India have not in general turned up to fight the infidels on the battlefields of Iraq and Afghanistan. But security analysts have meanwhile despaired at the unpreparedness of India's security agencies to counter a domestic Islamist threat. Whether or not al-Qaeda was behind the latest attack, that happy complacency must now have ended.

Correction: the dates given for the attacks in an early version of this article were wrong. They were corrected on 28th November 2008.

Thailand

Desperate days

Nov 27th 2008 | BANGKOK
From The Economist print edition

The anti-government mob goes all-out to cause chaos

A LAST, desperate attempt by Thailand's royalist People's Alliance for Democracy (PAD) to cause chaos and force the army to seize power looked dangerously close to succeeding as we went to press on November 27th. The prime minister, Somchai Wongsawat, pleaded with soldiers to stay in their barracks and a spokesman for the ruling party said that if they did not, supporters should block tanks with their cars. Two days earlier the PAD's yellow-shirted supporters had seized Bangkok's main international airport, cutting all flights. The next day the army chief, General Anupong Paochinda, had urged the government to call fresh elections and the PAD to cease its protests. But both sides spurned his call, increasing the chances of army intervention.

AP



No happy landings

The general was forced to speak out by the growing violence on the capital's streets. On November 25th PAD "guards" had shot at government supporters on a Bangkok motorway. On the morning of the 26th explosions were heard around both the main airport, Suvarnabhumi, and the capital's second airport (where the government has had its temporary offices since the PAD's seizure of Government House in August). Later, police said government supporters had shot an anti-government activist in Chiang Mai, in the north.

The PAD promised to summon a crowd of over 100,000 this week for its "final battle" to topple the government, which is allied to Mr Somchai's brother-in-law, Thaksin Shinawatra, the prime minister deposed in the coup of 2006. But only a fraction of that number turned out. The PAD's increasingly thuggish tactics have lost it much of the support it had from middle-class Bangkokians.

However, despite its dwindling support, the PAD's remaining crowds, a few tens of thousands at most, have been left unchecked to create havoc. The government and the police, having suffered fierce criticism from pro-PAD newspapers after deadly clashes in October, have stood back, hoping that the protesters' excesses would lose them support. The army has so far declined to stage a coup, as the PAD wants. But it has also refused to help the police tackle the protesters, who claim support from Queen Sirikit.

It is now three years since the PAD's founder, Sondhi Limthongkul, began holding rallies to protest at corruption and abuses of power by Mr Thaksin. The 2006 coup seemed to grant the PAD its wish. His Thai Rak Thai party, whose policies of cheap health care and microcredit had won strong support from rural voters, was subsequently dissolved. But last December, after 15 months of dismal army-backed rule,

voters returned to power a coalition led by Mr Thaksin's new People's Power Party (PPP), prompting the PAD to resume its protests.

The Thai crisis is complex and the motives of its actors are not always clear. But it has increasingly looked like a fight to the death by the country's traditional, royalist elite against a threat to its dominance from an authoritarian but highly popular leader from outside that Bangkok-based clique. The PAD claims that Mr Thaksin is plotting to overthrow the revered King Bhumibol and install a republic. This is probably untrue. But the businessman-turned-politician was becoming a rival to the king for the public's affections. The PAD, arguing that the masses are too "uneducated" to choose sensible leaders and resist vote-buying, wants to restore the semi-democracy of the 1980s, increasing the influence of the army, palace and royalist bureaucracy and diluting the popular vote.

Mr Thaksin, despite recently having been convicted *in absentia* for corruption, is not giving up yet. He recently staged a rally of around 70,000 of his red-shirted supporters at a sports stadium, to address them by telephone. The exiled ex-leader is promising another big gathering in December. His main message seems to be: I am still popular and still here. Some diehard supporters have sent a tougher message, threatening to bomb the PAD's rallies. Several PAD supporters have been killed or maimed in explosions this month. However, it is unclear which of these were caused by the group's foes and which by its own bombs.

The government, abandoning Bangkok to gather in Chiang Mai, Mr Thaksin's home turf, insists it will not budge. Busy dodging bands of marauding protesters, its ministers have been doing precious little governing, at a time when Thailand's exports are crumbling, its vital tourist trade faces collapse and unemployment seems likely to soar. The courts may soon dissolve the PPP for alleged vote-buying in last December's election. But Mr Thaksin already has a third party, Puea Thai, to take its place, with a cousin, Chaisit Shinawatra, reportedly lined up to lead it. The Thaksinites seem likely to win a fair election.

More unpredictable than ever, Thai politics is in a dangerous phase. Even if there is not a "hard" coup, some sort of softer military-judicial coup is possible—perhaps like the state of emergency imposed last year in Bangladesh—putting a civilian front on a government backed by the army and palace. But if this happens, Mr Thaksin's increasingly angry redshirts threaten to take the place of the royalist yellow-shirts, hitting the streets to bring down the new government. Three years on, it is hard to foresee a happy ending to Thailand's political strife, just a variety of sad ones.



WORLD
ASIA

Afghanistan's great purple hope

Bring on the pomegranate

Nov 27th 2008 | KABUL
From The Economist print edition

The hope that a health food can defeat drugs lords and the Taliban

THE Koran mentions the pomegranate as one of the fruits found in paradise, and medical research suggests it may help those wanting to extend their stay in this world. Rich in antioxidants, the pomegranate is promoted in the West as a defence against prostate cancer, heart disease and other illnesses. So in Afghanistan, where the United Nations reports another hefty Afghan opium harvest this year, the hope is that this life-giving fruit can displace the life-sapping drug trade that is, moreover, closely tied to the Taliban insurgency.

In early November the Afghan agriculture ministry and the United States Agency for International Development (USAID) held a World Pomegranate Fair at a model farm on the edge of Kabul. The organisers pointed out that pomegranate prices had quadrupled in five years, making the fruit a potential rival to the lucrative poppy.

Bill Phillimore, a Californian magnate producing a range of juices branded as POM Wonderful, told a group of craggy Afghan farmers how his company makes multimillion-dollar profits from the fruit. His audience was somewhat bemused. “The thing we wanted was some vital instructions on how to grow our pomegranate trees but they have just given us this book, which is empty,” said Gulam Haider, a 60-year-old farmer from Kapisa province, pointing to a notebook handed out by the organisers. It was blank, except for an exhortation against growing poppies.

Kandahar, in the south of the country, produces perhaps the world’s best pomegranates, medium-sweet ruby-red fruit that are savoured by connoisseurs, particularly in India. But Kandahar also lies in the heart of Taliban and opium country. That is only the start of the problem. All attempts to develop Afghanistan as an agricultural exporter suffer from fundamental difficulties: lack of fertiliser and pesticides, a poor road network, shortages of electricity and cold-storage depots, and only rudimentary packaging. Add the country’s landlocked geography and Afghan agriculture remains perennially uncompetitive.

Mannish Gaba, an Indian fruit importer, complains that Afghan pomegranate farmers have only wooden boxes in which to pack their produce. This damages the fruit. Strict border controls mean that Afghan lorries must be completely unloaded twice on their way to Delhi to satisfy Pakistani and Indian border officials.

Afghan poppy-watchers are cynical about the chances of alternative crops producing quick results. Mint, saffron and cotton are just three of the crops that have been promoted, yet all have so far failed to make a dent in Afghanistan’s only significant export. Some agricultural experts also argue that the outside world’s relentless focus on developing agricultural exports is perverse in a country that has long been a net food importer and whose people suffer from widespread nutrition deficiencies. Pomegranates are, at best, only part of the solution. One Afghan development expert says the country needs a synergy between a variety of alternative crops, infrastructural development, better governance, security and time—perhaps up to 20 years.

For now, the opium poppy’s biggest foe is its own success. Opium prices have dropped over the past four years as the supply from Afghanistan has consistently outstripped global demand. Moreover, food prices have risen sharply. The UN’s drugs survey for Afghanistan, released on November 27th, reports a 19% reduction in poppy production in the past year.



Some 18 out of 34 provinces are now poppy-free, up from 13 in 2007. The correlation between areas of Taliban instability and poppy production has become ever more pronounced—98% of Afghan poppies are grown in just seven, highly unstable, southern provinces. Helmand alone accounts for 66% of the total crop. The Taliban and drugs mafias operate symbiotically; the former finance themselves from the drugs trade to the tune of hundreds of millions of dollars a year, while the latter have a vested interest in insecurity that encourages poppy cultivation.

The UN reckons the drugs industry has shrunk from $4 billion to $3.4 billion (equivalent to around 30% of the licit economy). The price gap per hectare between opium and wheat has narrowed from 10:1 to around 3:1 or less. This suggests that poppy production may continue to drop. Rising food prices may be good for the war against poppy, but hurt many Afghans. The UN’s World Food Programme estimates that the cost of food for the average Afghan family has risen from 50% of income to around 85% in some areas during the last year. Even the healthy pomegranate cannot cure all of Afghanistan’s ills.

Australia's government

Happy birthday

Nov 27th 2008 | SYDNEY
From The Economist print edition

The crunch extends the honeymoon

AP


Honcho in a poncho

KEVIN RUDD'S love of foreign summitry is doing him no harm at home; if anything, it reinforces the Australian prime minister's image as a capable leader tackling the effects of the global credit crunch. Mr Rudd has spent nearly two of his first 12 months in office abroad. His first anniversary in power on November 24th was spent flying home from an Asia-Pacific summit in Peru.

An opinion poll gave the government a ten-point lead (after distributing votes under Australia's preferential system) over the conservative coalition that ran Australia for four terms under John Howard—higher than its vote at the 2007 election. As preferred prime minister, Mr Rudd scored a 42-point lead over Malcolm Turnbull, the second leader of the conservative Liberal Party since Mr Howard's demise.

But if the financial crisis has strengthened Mr Rudd—an opinion poll in mid-November showed 68% of voters approved his handling of the economy—it may yet store up troubles. Australia's first Labor leader in almost 12 years faces a crucial test: how to implement his bold plans during the rest of his first term, and at the same time keep the economy out of recession.

Mr Rudd's early ratification of the Kyoto protocol on climate change, and his apology to indigenous Australians, made his government look serious about keeping its electoral promises. Once a bit of an enigma, Mr Rudd has since projected an image that Australians seem to like: a hard-working (if slightly dull and wordy) leader with tight control over his ministers and calm assurance over policy. In another break with the past, he has taken cabinet meetings out of the cocoon of Canberra to the Northern Territory, Tasmania and other remote corners of Australia, where locals are encouraged to air their gripes.

But his challenges may only be starting. Mr Rudd campaigned last year as a "fiscal conservative", pitching a case to voters that Labor was at least the coalition's match as an economic manager. Since the financial crisis arrived, he has showed he is prepared to ditch that to stimulate a slowing economy. In mid-October, the government offered A$10.4 billion ($6.7 billion) to pensioners, families and first-home buyers. The cash will arrive just in time for Christmas spending. Two more packages followed this month: about A$6 billion to help Australia's ailing car industry, a big employer; and A$300 million divided between 400 mayors to spend on repairing town halls, building parks and other local-government projects.

All this has raised questions about whether Mr Rudd can keep the rest of his promises. His economic plan had assumed that hefty budget surpluses would pay for upgrades of schools, hospitals and creaking infrastructure. But the Treasury announced recently that the 2008-09 surplus of almost A$22 billion had been slashed by almost three-quarters, largely thanks to the credit crunch. Some economists say deficits after that are almost inevitable. After presiding over three interest-rate cuts since September, Glenn Stevens, the central-bank governor, has suggested that deficits in the current economic climate, in fact, were no bad thing if they finance "worthwhile" projects. He said that Australia's biggest mistake would not be to go into deficit, but "to talk ourselves into unnecessary economic weakness".

But Mr Rudd's two most ambitious plans are yet to play out: a reform of Australia's 107-year-old federal structure, and an emissions-trading scheme due to start in 2010. His government's standing may well hinge on his skill in pursuing these plans in the teeth of the financial crisis.

The EU and China

The summit of discourtesy

Nov 27th 2008 | BRUSSELS
From The Economist print edition

Crisis or no crisis, China’s diplomatic priorities prevail

SUMMITS are a dime a dozen these days. So it is tempting to shrug off the announcement on November 26th that China pulled out of an EU-China summit, at less than a week’s notice. But China’s high-profile snub—aimed at President Nicolas Sarkozy of France, who was to be the host on the European Union side—cannot be dismissed so easily.

Cancelling a meeting at such a high level is a rare breach of diplomatic manners. Mr Sarkozy has irked China by proposing to meet the Dalai Lama at a party in Poland for former winners of the Nobel peace prize on December 6th. Before then, he was due to play host to the Chinese prime minister, Wen Jiabao, in the French city of Lyon, in his capacity as holder of the rotating presidency of the EU. Some of the EU’s regular summits with China are very dull. This one had important things to discuss, such as joint action on tackling the global financial crisis. An official EU statement regretted the summit’s postponement, “particularly” at a time when the world situation calls for “very close co-operation”.

Mr Sarkozy seems singled out for special punishment. Both Angela Merkel of Germany and Gordon Brown of Britain have met the Dalai Lama in the recent past, without triggering such diplomatic fireworks. Mr Sarkozy, a mercurial chap, may not have prepared the ground with Beijing for his meeting with the Dalai Lama quite as diligently as did Ms Merkel and Mr Brown, diplomats suggest. Also, France and China have had some bruising spats this year: Mr Sarkozy criticised China’s handling of unrest in Tibet; the Olympic-torch relay was disrupted by protests in Paris (as in London); Mr Sarkozy hinted he might stay away from the opening of the Beijing Olympics unless China started talks with the Dalai Lama. Reprisals followed, notably an apparently temporary tourism boycott of France by China.

But other things are in motion. Recently the French, who will surrender the EU presidency at the end of December, unexpectedly put out feelers to see if other EU countries wanted to move ahead with a long-delayed EU code of conduct on arms sales to China. That code of conduct has long been presented by the French as the key to a much bigger prize for China: the scrapping of an EU embargo on arms sales to China, dating back to the 1989 Tiananmen massacre. The French, it is said, found little enthusiasm for movement on the arms-for-China dossier. America dislikes any idea of EU arms helping China modernise its army, since American troops might one day be on the wrong end of such lethal toys, in a fight over Taiwan. European leaders are not about to annoy the new President Obama, just to please China.



WORLD
ASIA

Guns N' Roses

Rock in a hard place

Nov 27th 2008 | BEIJING
From The Economist print edition

It's only rock and roll but the Chinese Communist Party doesn't like it

ITS name recalls both Mao Zedong's dictum about where political power comes from and the rose revolution in Georgia in 2003, one of several movements that unseated authoritarian regimes in post-communist societies. So it is perhaps not surprising that the fan base of Guns N' Roses, an American rock band, seems not to include the higher ranks of the Chinese Communist Party. Then there is the matter of the band's new album: "Chinese Democracy".

Government spokesmen have said little about it. But *Global Times*, a party newspaper, has described it as a "venomous attack" and part of a Western plot "to control the world using democracy as a pawn". All of which may flatter the band. First conceived by Axl Rose, the band's leader, in 1994, the work features plenty of the driving rhythms, slashing guitars and screeching falsetto vocals beloved by the band's fans.

But it offers little in the way of coherent political discourse, though the title song includes a gratuitous mention of China's banned Falun Gong meditation movement. If there is a message, it may be the lines, perhaps addressed to the Chinese government: "You think you've got it all locked up inside and if you beat 'em enough they'll die"; and "if your Great Wall rocks, blame yourself".

The mere mention of Falun Gong is enough to preclude open distribution. Access to several of the band's websites has been blocked in China. But anyone interested probably knows how to bypass the censors. China's own musicians have long struggled to explore the subversive side of rock-and-roll culture without angering their government. Music-industry figures in Beijing were reluctant to speak openly about the controversy, but one marvelled privately at the "stupidity" of the panning of the album, saying Chinese rock fans might otherwise never have heard of it.

Western rockers have bumped up against the Chinese censors before. In 2006 the Rolling Stones agreed not to sing some songs in China. Others have pushed back. Björk, an Icelandic singer, shouted "Tibet!" following her song "Independence" in Shanghai this year. Such bravado hardly seems likely to shake China's government. But who knows? Christopher Hughes, a China scholar at the London School of Economics, notes: "The history of rock shows that it beats the authorities every time, everywhere." Mao would have disagreed.



WORLD
ASIA

Sex, death and the law in Hong Kong

Easy prey

Nov 27th 2008 | HONG KONG
From The Economist print edition

The law may be endangering prostitutes in Hong Kong

JUST after midnight on November 23rd, the landlady of a building in an older district of Hong Kong checked on one of her tenants, a prostitute. The sheets were bloody and the woman was dead, apparently strangled. The murder was similar to four killings that occurred in March—three in the New Territories on the mainland, one on Hong Kong island. The investigation that followed quickly led to the arrest of one man accused of the first three killings and another for the fourth, deemed to be a copycat crime.

The latest death has prompted police to raid prostitutes' haunts and scrutinise footage from Hong Kong's ubiquitous video cameras. Critical clues in the March killings were said to include video images and the use of an electronic pass for the city's metro that allowed police to trace a suspect's movements. But as effective as the Hong Kong police may be in capturing criminals, the murders have raised a wider question: rather than protecting prostitutes, are Hong Kong's laws contributing to their deaths?

Seeking to ensure that women are not forced into prostitution, Hong Kong makes it illegal for anyone but the prostitute to profit from her services. A laudable sentiment, perhaps. But the consequence is that a sex worker in Hong Kong may not hire the basic protection an office worker would expect, nor is she permitted under the law to share her quarters with other women. As a result, prostitutes are uniquely vulnerable.

To some extent, this vulnerability is mitigated by the triads—local gangsters —and by informal co-operation among prostitutes. But the informal support is of limited use against a violent client, and providing business opportunities for gangsters is hardly desirable.

A recent Hong Kong court decision raises more awkward questions. On May 15th the owner of a website that carried advertisements for prostitutes was sentenced to 18 months in jail for conspiring to live off prostitutes' earnings. By this standard, who else might be guilty? Local newspapers carry solicitation advertisements, and could in theory be prosecuted (none has been), as could landlords, doctors who treat prostitutes and even, notes one legal critic, the Water Authority, which enables a prostitute to take a shower—sometimes presumably with a client. Plainly, better and clearer rules are needed.

Moonlighting in audio

Nov 27th 2008
From The Economist print edition

Celina Dunlop, *The Economist*'s picture editor, has been recognised for her radio work. This week her programme, “The My Lai Tapes”, won the Foreign Press Association award for radio story of the year. It had already won this year's BBC Audio and Music award for best journalism.

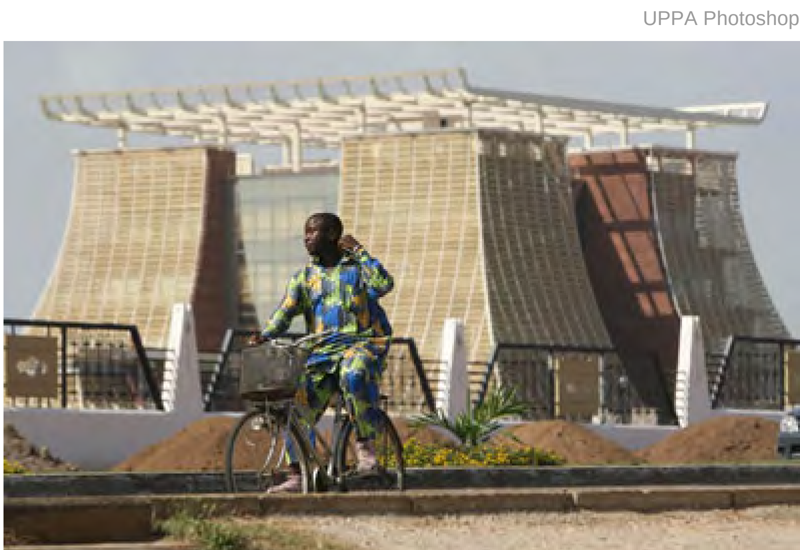
Ghana's election

Hold your breath

Nov 27th 2008 | ACCRA
From The Economist print edition

The country considered one of Africa’s biggest recent successes is going to the polls. The handling of the election matters for the whole continent

UPPA Photoshop



LAST year oil was found off the coast of Ghana. There was rejoicing, of course. But the mood was tempered by the knowledge of how oil has polluted the nearby Niger Delta and corrupted Nigeria. More than anything, Ghanaians were seized by a determination to avoid the “resource curse” of Nigeria.

Now, with a general election on December 7th, it is the curse of the ballot box that Ghanaians want to avoid. After electoral disasters in Nigeria, Kenya and Zimbabwe in the past 18 months, everyone is hoping, and many are praying, that Ghana will avoid the bloodshed, chicanery and political warring of its African peers.

Even more so as Ghana, with annual growth rates of about 6% during the past few years, is one of Africa’s few undisputed successes of the past decade. It plunged the depths of despotism and kleptocracy in the 1970s and 1980s, but has fostered an enviable reputation for individual freedom and political stability since democracy was restored in 1991. This has attracted a lot of financial and diplomatic investment. For the sake of African democracy as much as of Ghana itself, nobody wants to jeopardise all of that with the sort of chaos that hurt Kenya earlier this year.

In this respect, Ghana has several advantages over Kenya, Nigeria and Zimbabwe. It has a highly competent electoral commission, whose independence is respected by all Ghana’s politicians. Above all, ordinary Ghanaians are acutely aware of the eyes of Africa and the world upon them. Foreign-aid and human-rights bodies, diplomats and church people all hold daily meetings and workshops with titles such as “Elections: Lessons from Zimbabwe and Kenya for Ghana”. A sense of pan-African responsibility prevails.

Ever since Ghana became the first sub-Saharan country to win independence (from Britain) in 1957, Ghanaians have been conscious of being in the vanguard of African history. Emmanuel Gyimah-Boadi of the Ghana Centre for Democratic Development says it is still the case. “There is a popular desire to maintain a record of not behaving like others on the continent in these elections. It is a point of pride.”

So an electoral disaster might be avoided. But Mr Gyimah-Boadi says that the dangers are still real. For a start, as in Kenya, the two main parties, the ruling New Patriotic Party (NPP) and the National Democratic Congress (NDC), are very evenly matched. This gives them every incentive to cheat, knowing that just a

few votes either way could tip the balance. The parties both claim they will win the presidential ballot on the first round. Yet it is thought they are both a few percentage points shy of the 51% they need to win outright and avoid a second round.

There is also a lot of ill-feeling between the two parties. It has already provoked violence in the north. In one incident the NDC says two of its organisers were shot dead. The opposition resents the way the NPP has used its time in government to jail several NDC former ministers on charges from the time the NDC was in office in the 1990s, while taking no action against present government ministers who have been accused of corruption. NDC members talk of a political vendetta against them; many want vengeance.

On top of this, the oil discovery has raised the stakes. The winner, after all, will be looking at a bonanza of about $3 billion a year in oil revenues from as early as 2010. Never will there have been a better time to be in government in Ghana.

So it is an irony, given the charged atmosphere, that the policies of the NPP on the centre-right and the NDC on the centre-left are not that far apart. Both pledge largely to continue the more-or-less orthodox free-market policies that have served Ghana well for the past few years.

The NPP's presidential candidate, the energetic Nana Akufo-Addo, is happy to campaign on the present government's record. He trades on the popularity of the outgoing president, John Kufuor, in office since 2001. Mr Akufo-Addo, who was foreign minister and attorney-general in Mr Kufuor's two governments, hopes his experience and a pedigree as the son of a former president will help him to victory.

The NDC is led by the quieter John Atta Mills. A lawyer, academic and former vice-president, he has lost the last two elections to Mr Kufuor, so this is probably his last tilt at the presidency. His NDC talks more about social justice than the NPP does. It also has its former leader, the extrovert and populist Jerry Rawlings, on the campaign trail to stir up support. Mr Rawlings can still wow a crowd but he repels as many people as he attracts. Many recall his thuggish ways as president in the 1980s; he is as much a liability as an asset to the NDC.

In the end, the two parties' differences have come to be encapsulated in the saga of the new presidential palace. Now almost finished, this huge building is shaped like an Ashanti stool to symbolise that ancient source of authority. It is bold and showy but also hugely expensive. Nobody knows for sure, but the bill could be as high as $50m. The NDC argues that this, as well as new presidential jets, is a wasteful extravagance in a country where many people are still miserably poor. The NDC also says the haziness of the accounts points to corruption and a lack of accountability.

The NPP ripostes that such a building was long overdue. Until now, the presidential offices have been in a former Danish slaving castle by the port of Accra. "If ever there was an inappropriate symbol of the new Ghana, that was it," snaps Mr Akufo-Addo. The new building represents the nation's growing self-confidence and dignity. And anyway, the would-be president adds, it was built with Indian money—a sign of global interest in the new Ghana.

Transport in Africa

On your bike

Nov 27th 2008 | NAIROBI
From The Economist print edition

A scheme to encourage cheap transport on two wheels

Illustration by Claudio Munoz

PEDAL power has never really taken off in Africa. Cycling enthusiasts blame the sweltering heat, potholes, and the dumping of Chinese bikes unsuitable for glutinous dirt roads for the ascendancy of belching minivans, even over short distances. Still, bike-crazy pockets of the continent show what is possible. Smugglers on the Kenya-Uganda border popularised the boda-boda taxi (originally, border-border) in the 1970s: boda-bodas still ply village-to-market routes across Africa's Great Lakes region, carrying passengers or sacks of maize on their often funereal velveteen back seats.

Groups of concerned cyclists in Europe and America have long shipped containers of used bikes to Africa but this bike aid has yet to roll into a movement with critical mass. Indeed, Africans tend to turn their back on bikes as soon as they can afford anything with an engine. The bike has suffered from the indifference of car-driving rulers. There are hardly any bike paths; few people campaign for pedalling. Cyclists rarely contribute to their own safety. Helmets and reflectors or lights at night are rare. Maintenance is invariably slapdash. Yet, with low purchase and running costs, the humble bike could be a key to mobilising rural Africans and unclogging the cities.

One problem is that few bikes are manufactured in Africa. Some charities customise bikes for rural health workers. A more ambitious plan, led by an American bike-maker, Craig Calfee, and a group of scientists at the Lamont-Doherty Earth Observatory in New York, aims to introduce and sell bamboo bikes in Africa.

Bamboo has a higher tensile strength than steel and can be taped together with natural fibre and resin. A finished frame should be light, easy to handle and ideal for carrying goods. Production is set to begin next year in Ghana's second city, Kumasi, in the hope of selling bikes for $55 on a business plan backed by KPMG, an accountancy firm. Material will come from bamboo forests in the surrounding Ashanti region, with wheels and other parts imported. If the Kumasi bike proves durable, workshops across Africa could start turning out their own versions.

Swaziland

It's good to be king

Nov 27th 2008 | JOHANNESBURG
From The Economist print edition

Despite its new constitution, the Swazi monarchy still looks absolute

WHILE Zimbabwe is roundly condemned by all and sundry, the nearby tiny kingdom of Swaziland, tucked between South Africa and Mozambique, has largely escaped scrutiny. After elections in September that few considered free or fair, the government has branded several organisations as terrorist and has put the opposition leader, Mario Masuku of the People's United Democratic Movement (Pudemo), behind bars. Yet Swaziland chairs the body dealing with peace and security for the Southern African Development Community (SADC), a regional club of 15 countries that has been mandated to bring democracy to Zimbabwe.

The adoption of a constitution in 2005, supposed to guarantee basic freedoms, was widely deemed a good step. But King Mswati III retains executive power and remains above the law. He appoints ministers and judges, and can veto bills. Political parties have been banned since 1973, so aspiring members of parliament have to run as independents and be vetted by local chiefs. The High Court is mulling over a constitutional challenge, arguing that the electoral commission, which is meant to be independent, is in fact under the king's thumb. The ruling will indicate how far the king's powers still go.

Swaziland remains a deeply traditional and rural society, where chiefs wield a lot of authority. Dissent is largely confined to cities. But the lavish celebrations of the king's 40th birthday, coupled with the 40th anniversary of independence from Britain, made the royal family's lifestyle look even more outrageously extravagant in a country where most people are dirt-poor and AIDS is ravaging the population of just about 1m.

In August, angry protesters called on the authorities to spend more on easing the country's hunger and tackling AIDS, after reports that eight of the king's 13 wives had been on holidays in the Middle East and Asia with large entourages. In September thousands of pro-democracy campaigners took to the streets to demand reform. But SADC, while wringing its hands over Zimbabwe, seems loth to take the king to task.

Dubai

Has the bubble burst?

Nov 27th 2008 | DUBAI
From The Economist print edition

As the sheen comes off glitzy Dubai, the other Gulf states are getting nervous too

“THEY said you couldn’t create islands in the middle of a city,” shouts a property advertisement over a jammed Dubai motorway. “We said, what’s next?” The range of answers has become gloomier by the week, as the debate moves from whether the Dubai property bubble will burst to just how bad it is going to get. Some nervous bankers think property prices could fall by 80% or so in the next year or so. A few months ago, rich foreigners who had bought villas in Dubai were complaining about the quality of the sand on their artificial beaches or the difficulty of getting water to circulate around the twiddly fronds of the man-made island shaped like a palm. Now prices for some smart developments have been cut by 40% since September, shares in property firms have lost 80% of their value since June, and big developers are laying people off.

The region’s banks will suffer too. Gulf policymakers are still making cheery statements about the region’s limited exposure to subprime loans but are quieter about heavy investments in inflated local property markets by regional banks, particularly Islamic ones. But worried banks are sharply reining in their mortgage lending. A series of arrests of senior businessmen as part of a fraud investigation is also making people twitchy. There is even talk of a coming “Gulf Enron”.

While the stunning opacity of government economic data is increasing the air of uncertainty, Muhammad Alabbar, who heads Emaar, a giant state-controlled property developer, took the rare step of telling people how indebted the country is. Together, the government and state-owned enterprises owe $80 billion—148% of GDP. Dubai still has a far larger stock of assets, at least some of which are likely to be sold, to cover the debts, to Abu Dhabi or the federal sovereign-wealth fund of the seven-state United Arab Emirates, of which Dubai and Abu Dhabi are the two richest.

The rest of the Gulf has met Dubai’s phenomenal boom with a mixture of envy and emulation. Now there are hints of pleasure at the idea that the epicentre of bullishness may be humbled. But there are worrying questions for the others, too. Could the Dubai property slump prove contagious? Will the Gulf Co-operation Council pull together to protect the region’s economy? Should its planned monetary union be set aside as governments focus on protecting their own currency?

Who do we listen to now?

Since everyone else has been trying to copy Dubai, it is unclear how economic policy should be reshaped if the model has to be rescued. Advisers who have been preaching free markets and foreign investment will have a tougher time as economic power shifts back to the more conservative, oil-rich governments such as Abu Dhabi and Saudi Arabia.

Political stability may be affected too. A worsening economy may encourage political reform, on the assumption that people can be more easily bought off in times of plenty. At a recent BBC debate in Doha, Qatar’s capital, on whether Gulf Arabs value profit over people, young Qataris said critics of their countries’ poor treatment of foreign workers should look on the bright side; local citizens benefit from large gifts of land and free university education. Since the oil boom began in 2003, mega-rich Qatar has ramped up public spending by an average of 28% per year; the less well-endowed states have had to make do with annual rises of some 15-20%.

Several GCC economies will go into budget deficits next year for the first time since at least 2002, including Saudi Arabia, whose budget is based on oil at around $50 a barrel but excludes the cost of Saudi Aramco’s massive programme of capacity expansion. Unemployment will rise as thousands more young people, many of them graduates with high expectations, enter the job market. Social unrest is likely to brew. The question is whether governments will meet it with repression or political concessions.

Israel

The fading of Labour

Nov 27th 2008
From The Economist print edition

The party of the old establishment is dying under Ehud Barak

AP



Barak at bay

“I AM not perfect,” acknowledged the leader of Israel’s Labour party, Ehud Barak in a recent internet interview. With elections ten weeks away and Labour, a junior partner in the present coalition government, below 10% in all the polls and falling, this concession may seem self-evident. For Mr Barak, though, it is something of a departure. Even his friends grumble at his egotism. His traducers call it chronic insensitivity, both to the voters and to his own despairing party faithful.

In the interview and in a rare appearance two days earlier in Israel’s parliament, the Knesset, Mr Barak, Israel’s present minister of defence, was at his moderate, statesmanlike best. Every day of relative quiet on Israel’s border with the troubled Gaza Strip was a blessing, he said. Calls for a military showdown with Hamas, the Islamist movement that runs Gaza, were cheap, irresponsible electioneering. He would share Jerusalem with a Palestinian state and find wording to address the Palestinian refugees’ declared right of return. The Saudi peace plan was full of promise and he would pursue it. Binyamin Netanyahu, leader of the opposition Likud party, who pollsters say is pulling ahead of Tzipi Livni, leader of the Kadima party that heads the current ruling coalition, would lead the country into confrontation with the world. Mr Barak would not join a government led by him unless it were committed to negotiate vigorously with the Palestinians and Syrians.

But Mr Barak’s political obtuseness has been on display too. He insists on keeping slots on Labour’s list of Knesset candidates for two of his chums, to the chagrin of young campaigners hoping to win these slots in primary elections. This week Labour’s appeals board overruled this arrangement but Mr Barak ordered another appeal in an attempt to reinstate it.

Most of the parties will hold their primaries in the next fortnight; then the campaign will get going in earnest. Labour faces a pincer attack from Kadima on its right flank and from a reinvigorated Meretz, the most peace-minded of the mainstream parties, on its left. Many leading intellectuals, including the authors Amos Oz and David Grossman, are backing Meretz rather than Labour this time.

Mr Barak disparages those two rival parties as “atmospheric”, fashionable fly-by-nights without Labour’s deep ideological and organisational roots. Ms Livni is “a worthy woman”, he says, but surrounded by opportunists. Many Kadima members of parliament jumped the Likud ship when its captain, Ariel Sharon, the then prime minister, split off to form the new party; they might re-rat into the Likud if Mr Netanyahu made suitable inducements. As for Mr Oz and the writers, they, Mr Barak indicated, have been flitting between Labour and Meretz for decades.

All true, but not much consolation. Labour’s problems stem also from the hijacking of its message by others and the dissolution of party loyalties. Its peace policy is now hardly distinguishable from that of Kadima or indeed Meretz: a two-state solution based on the 1967 border, with land swaps and the

retention of the bigger Jewish settlement blocks, as outlined by Mr Barak when he was prime minister from 1999-2001. It won the support of Presidents Clinton and Bush and will almost certainly get President Obama's nod too.

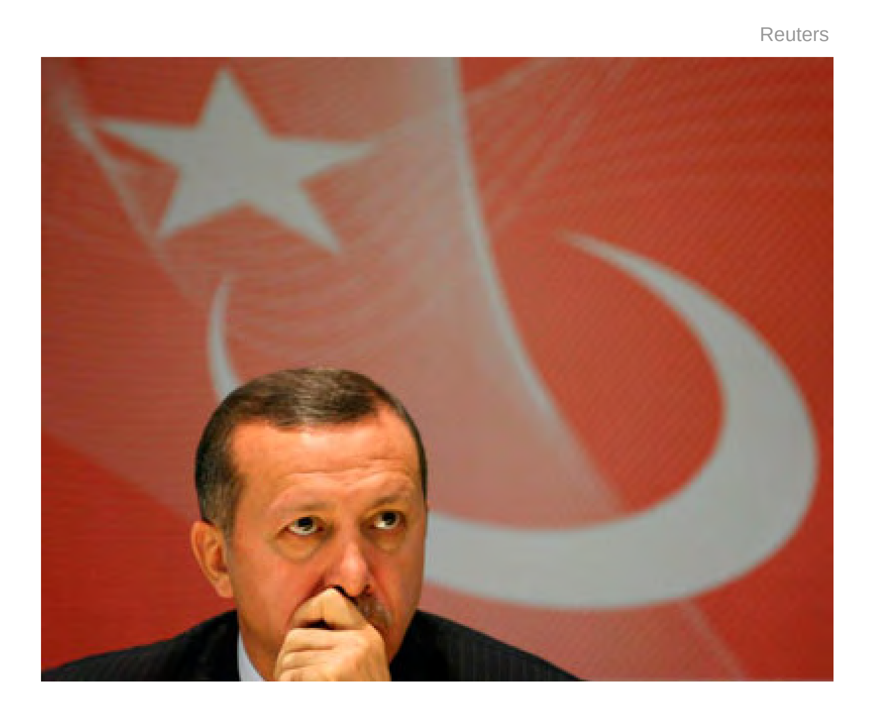
But who and what is Labour these days? Key figures, including Israel's president, Shimon Peres, and the Knesset's speaker, Dalia Itzik, are now in Kadima. Others drifted to Meretz over the years, including that party's three most recent leaders: Shulamit Aloni, Yossi Sarid and Yossi Beilin. Mr Barak's new feistiness is welcome to his own party's dwindling faithful. But, even for the most nostalgic Labour loyalist, its glory days look over.

The worrying Tayyip Erdogan

Nov 27th 2008 | ANKARA
From The Economist print edition

Turkey's prime minister once promised big reforms to bring his country closer to the European Union. He seems no longer to be pushing them

Reuters



WHEN Turkey's prime minister, Recep Tayyip Erdogan, and his Justice and Development (AK) Party narrowly escaped banning by the constitutional court in July, the big question was which Erdogan would then come to the fore. Would it be the non-ideological pragmatist, whose bold reforms had helped Turkey to secure the start of membership talks with the European Union in 2005? Or would it be the dogmatic and erratic leader who had provoked Turkey's meddlesome generals, always anxious to undermine the AK Party because of its Islamist roots, by seeking soon after his election victory in July 2007 to ease the ban on the Islamic-style headscarf in universities?

The question of which version of Mr Erdogan is in charge has gained extra urgency because Turkey is grappling with mounting violence in the mainly Kurdish south-east. It also matters to the financial markets as the government tries to protect its fragile economy from the global financial typhoon. Worryingly, the answer seems to be: the second version. Mr Erdogan appears increasingly autocratic and out of touch. And because he lacks any credible political opponents, either within or beyond the AK Party, this is making Turkey look stagnant and adrift—and further away from EU membership than ever.

Mr Erdogan's odd behaviour was on display during his most recent trip to America. When asked in Washington for his view about Iran's nuclear ambitions he retorted that "those who possess nuclear weapons do not have the right to tell others to not acquire them too." This comment did not go down well with American officials, whose memories are seared by Turkey's refusal in March 2003 to let America use its soil to launch a second front against Iraq. A recent gas deal struck by the Turks with Iran has not helped. For all of Turkey's assistance over Iraq since 2003 (some 70% of non-combat materiel for American troops goes through Turkey) and in Afghanistan (where Turkey has 1,200 troops), America is asking new questions about Turkish dependability as a Western ally.

Another thundercloud is gathering over demands by the Armenian diaspora in America, most of whom strongly supported Barack Obama's election as president, that he stick to the view he expressed as a senator that the massacre of Ottoman Armenians in 1915 should be seen as "genocide". Turkey's recent efforts at reconciliation with Armenia, motivated in part by hopes of staving off a formal recognition of genocide by the Obama administration, seem to be making little progress. Some Western diplomats

ascribe this to the pressure hawks in the diaspora have applied to the Armenian president, Serzh Sargsyan.

But it is at home that Mr Erdogan is causing the most concern. The hope was that, with his legal travails behind him, the prime minister would resume much-delayed political and economic reforms. Instead he has adopted an increasingly strident nationalist line. There is talk of his having struck a deal with Turkey's new, hardline chief of staff, Ilker Basbug, according to which Mr Erdogan has promised to freeze reforms that dilute the army's power in exchange for his party's not being attacked in court again.

Mr Erdogan's new approach was most evident in a speech he gave earlier this month in the predominantly Kurdish town of Hakkari. Responding to a wave of bloody protests that has racked the Kurdish region, he invited those who were not happy to "go wherever they please". Ibrahim Guclu, an independent Kurdish politician, says that "in other words, he was telling the Kurds to get out." This is a far cry from a ground-breaking speech Mr Erdogan made in Diyarbakir three years ago, when he admitted that the Turkish state had made mistakes with the Kurds.

Now he is giving the army much freer rein in its 34-year campaign against the separatist Kurdistan Workers' Party (PKK). When *Taraf*, a liberal Turkish newspaper, exposed army negligence in a recent PKK attack that killed 17 soldiers at an outpost in Hakkari, he chose not to order an investigation and attacked the newspaper instead. His aides are reported to have blamed leaks of the intelligence reports cited by *Taraf* on Israel and the CIA.

Meanwhile EU-inspired work on drawing up a new constitution to replace the current one, drawn up by the generals after a military coup in 1980, has stalled. Reports of police torture and extra-judicial killings are on the rise. Turkey's liberal intelligentsia, long among Mr Erdogan's stalwart supporters, is grumbling, as is the European Commission. Mr Erdogan's response has been to rescind the press accreditation of several journalists who cover the prime ministry. All of this is giving more ammunition to those EU members that have never wanted Turkey to join their club.

Mr Erdogan owes much of his electoral success to the unprecedented economic stability of his time in office. By sticking firmly to IMF prescriptions Turkey helped foreign investment to soar, tamed inflation and narrowed the budget deficit. But the IMF standby arrangement expired in May. And although Mehmet Simsek, the economy minister, has repeatedly hinted that it should be extended, a deal remains elusive. Foreign investors, who hold as much as 70% of the Istanbul Stock Exchange, have been pulling out, and the lira has tumbled by more than a third against the dollar this year. Growth of GDP has dipped sharply, to below 2%. Turkey's huge current-account deficit makes it more vulnerable than many other emerging markets. Although it has so far been relatively unaffected by the world financial malady, it is only a matter of time "before it catches the bug", says one Istanbul-based banker.

Mr Erdogan's supporters insist that the government's inertia is mainly to do with municipal elections being held next March. An IMF deal would preclude a pre-electoral spending spree. Being too nice to the Kurds might strengthen the nationalist opposition in the face of spiralling PKK terrorism. "Once the elections are over, you'll see the old AK," promises Abdurrahman Kurt, an AK deputy from Diyarbakir.

But such promises are beginning to ring hollow. When Mr Erdogan won power a second time, with an even bigger share of the vote, in July 2007, he promised to reach out to all Turks "including those of you who didn't vote for me." He seems now to be alienating such voters. And as corruption also starts to infect the AK's ranks, it is beginning to resemble many of the tired old parties that it buried at the polls.

Greenland's future

Divorce up north?

Nov 27th 2008 | COPENHAGEN
From The Economist print edition

Greenland creeps towards independence

THIS week's referendum in Greenland marks a milestone in the protracted divorce proceedings between the world's largest island and Denmark, one of its smallest colonial powers. Over 75% of Greenlanders voted to give themselves the right to loosen ties with Denmark by slowly taking control of such areas as security, justice and police affairs. The vote also promises Greenland (population: 56,000) a bigger slice of future profits from minerals, including oil, rubies, gold and diamonds.

For most Greenlanders, the referendum was as replete with a sense of the righting of historic wrongs as Barack Obama's election in America. "I'm extremely moved, because now, like other peoples, we will be recognised as a nation," said Hans Enoksen, the premier. Yet although Mr Enoksen wept tears of joy in Nuuk, Greenland's capital, it is premature to assume that full Inuit independence will come quickly.

Jupiter Images



An icy independence looms

Denmark has ruled Greenland since the 18th century. It conceded limited home rule only in 1979 (Greenland chose to leave the then European Community in 1985). The Danes have conceded that Greenland has a right to divorce. But independence may be a dream that the Greenlanders cannot afford. The population is tiny and the problems vast. The main export is fish and a DKr3.4 billion ($590m) annual grant from Denmark pays for public services like education and health care.

Even with the grant, the difference in living standards between Greenland and Denmark is stark. Education is bad, nutrition is poor and problems like alcoholism and child abuse abound. To tackle these problems, Greenlanders would need a bigger source of income than the Danish subsidy, which would presumably be phased out. In theory, this could come from minerals, but exploiting these requires big investment that it might be hard to finance now. Greenland's west coast may hold more oil than the North Sea, but harsh conditions could push the cost of extraction as high as $50 a barrel.

"Expectations have been unrealistic," says Jens Frederiksen, leader of the Democrats, the only political party in Greenland to oppose this week's vote. Soren Espersen, a member of parliament for the Danish People's Party, is blunter: "Greenlanders have been brainwashed by unprecedented propaganda."

The French Socialist Party

War of the roses

Nov 27th 2008 | PARIS
From The Economist print edition

The party gains a new leader, Martine Aubry, but keeps its old divisions

FOR a party that has not won a presidential election in 20 years, the French Socialists are doing a spectacular job of keeping themselves unelectable. After a bitterly contested vote to pick a new leader, the party's national executive this week confirmed the victory of Martine Aubry over Ségolène Royal, by a wafer-thin margin of 102 votes out of 134,800 cast by members. The Socialists may have a new boss, but the outcome leaves the party divided, the candidates at each other's throats, and the rank-and-file nauseous.

The first count put Ms Aubry ahead by 42 votes. Both sides cried foul, with Ms Royal's lieutenants alleging fraud and cheating, and demanding a rerun. After two days of debate, the national executive pronounced Ms Aubry the victor. Ms Royal has accepted the vote grudgingly, adding that she would remain in the party.

The result could hardly have been worse. Ever since Lionel Jospin, the Socialist presidential candidate in 2002, was beaten in the first round by the far-right Jean-Marie Le Pen, the party has been looking for a leader with the authority and legitimacy to unite it and to make it electable. It now has a new boss with neither.

In her victory speech, Ms Aubry tried to reach out to Ms Royal, and vowed to "profoundly renew" the party. She is expected to promote more minorities and women to give the party a fresh face. Yet it is hard to see Ms Aubry, mayor of Lille, as a renovating force. She is on the party's left, as architect of the 35-hour working week, a policy that entrenched France's damaging reputation as a work-shy, high-cost place. Unlike Ms Royal, she has ruled out an alliance with François Bayrou's centrists—although she formed one to win election in Lille. Instead, she has leant left, relying on the backing of Benoît Hamon, a left-wing rival who wants to force companies that sell goods in Europe to make them there too.

Ms Aubry, who is the daughter of Jacques Delors, a former Socialist finance minister and president of the European Commission, is a machine politician who spent years toiling on the party's national executive. This marks her as an establishment traditionalist. In fact Ms Aubry and Ms Royal are both alumni of France's elite postgraduate Ecole Nationale d'Administration, as is François Hollande, the outgoing party boss (and Ms Royal's ex-partner). But Ms Royal has cleverly positioned herself as an outsider and Ms Aubry as an insider. By exploiting her blog network and power base as a regional president, she can appeal over the party elite in Paris to grass-roots supporters. This insurrectional strategy and her flaky style have made her intolerable to the party's "elephants".

AFP



Aubry on the left beats Royal on the right

In contrast, Ms Aubry was backed by all the elephants. These include Laurent Fabius, a former prime minister who almost split the party in the referendum on the European Union constitution in 2005; Dominique Strauss-Kahn, head of the IMF in Washington; and Bertrand Delanoë, the mayor of Paris. That they all, despite bitter past differences, rallied behind Ms Aubry shows that she was seen essentially as the anti-Royal candidate. “The old guard is using her as an anti-Ségolène weapon,” suggests Dominique Reynié, a political scientist at Sciences-Po, another elite academy.

Yet Ms Aubry’s victory resolves nothing. The quarrel over personalities will not subside. Ms Royal says she will be “a force of transformation” inside the party, which roughly translates as being an internal troublemaker. Each of them hopes to win the party’s presidential nomination for 2012, since that requires a separate vote, and Ms Aubry has no guarantee of the job. Only two of nine Socialist Party bosses have gone on to be the presidential candidate: François Mitterrand, successfully, in 1981, and Mr Jospin, unsuccessfully, twice.

And the small matter of the battle for ideas has been largely ducked. Ms Aubry’s rejection of any alliance with the centrists opens up space for Mr Bayrou. The party has not had a much-needed debate over the nature of the political left, let alone contributed a single useful thought to today’s crisis of capitalism. The dismal spectacle of recent weeks, against a backdrop of job losses and recession, has made the left its own best critic. Mr Hollande said he was “ashamed” of the party. *Libération*, a left-wing newspaper, described the tale as a “tragicomedy”, urging the party to “change or die”. Inevitably, the person most relishing the wreck is France’s centre-right president, Nicolas Sarkozy.

Eastern Europe's woes

Stopping the rot

Nov 27th 2008
From The Economist print edition

East European economies crack, with Romania and Bulgaria the worst off

JUST another week's news in eastern Europe: Latvia, after vehement denials, starts talks with the IMF; Bulgaria loses €220m ($286m) in promised payments from the European Union because of its failure to tackle corruption; and the European Bank for Reconstruction and Development cuts its growth forecast for the region by half. But the good news is that worries of a huge meltdown, from the Baltic to the Black Sea, now look overblown.

The most likely outcome is several years of low or no growth, with bigger hiccups in countries that have the shakiest financial systems and biggest imbalances. The outside world (ie, the IMF, the EU and the European Central Bank) is ready to help when necessary and—more usefully—even before problems hit markets. The ECB has opened a €10 billion credit line to Poland, which saw its currency, the zloty, fall sharply earlier this month. Hungary's central bank was even able to cut its interest rates by half a point from the 11.5% rate that it set last month, as part of a $25 billion international bail-out. And foreign banks have stood by their subsidiaries in the ex-communist countries. It was their risky lending that inflated the property bubbles, now popped, and also financed huge current-account deficits in such places as Latvia and Bulgaria.

The biggest worries are now focused on Bulgaria and Romania, the poorest and worst-governed new members of the EU. The Bulgarians have their hands tied by a currency board that pegs the lev rigidly to the euro. That rules out devaluation to restore competitiveness, which is a concern as exports sag. It also removes a potential buffer, because the central bank cannot adjust interest rates. A current-account deficit worth a quarter of GDP looks alarming.

At least Bulgaria's fiscal position is strong. The state has little foreign debt and runs a budget surplus. That should allow it to increase public spending as the economy slows. It can also borrow abroad (though the authorities say they have no plans to approach the IMF). The loss of some EU money is embarrassing, but Bulgaria is still in line to get €11 billion in the years up to 2013. Oriens, a Hungarian-based merchant bank that specialises in the Balkan region, reckons that growth next year will be 2.3%: low but not awful.

Romania has a current-account deficit of only 14% of GDP; a floating currency that gives it more flexibility; and is less dependent on exports to the slowing euro area than Bulgaria. But it may have a harder landing. Oriens forecasts GDP growth of just 0.9% next year. Its banking system is less profitable than Bulgaria's. Although it is mostly foreign-owned, it looks wobblier; inter-bank rates have nearly doubled this year to 15%. Foreign reserves are scantier and the IMF reckons that the currency, the leu, may be overvalued by 19%.

Thanks to populist spending in the run-up to this week's parliamentary election, the budget deficit may reach 3.9% of GDP by the year-end. That is not a lot by some standards, but it may still cloud outsiders' willingness to provide more cash. Whatever coalition the election produces, serious reform is a long way off. Bulgaria's politics are also troubling. Politicians' ties to organised crime remain scandalous; the main populist party seems to blame the country's Turkish minority as the economy slumps. Meltdown may have been averted, but the eastern Balkans still face bleak times ahead.

Ireland and Europe

A taoiseach in trouble

Nov 27th 2008 | DUBLIN
From The Economist print edition

The prime minister's problems may prove terminal for the Lisbon treaty

BRIAN COWEN, who succeeded Bertie Ahern as Ireland's prime minister (taoiseach) in May, calls it the worst economic crisis in a century. It is certainly the worst of times to be in government. The economy will shrink this year and probably next, for the first time in 25 years. The Celtic Tiger decade of high growth and huge budget surpluses has ended in a spectacular bust. Tax revenues have collapsed: the budget deficit may hit 7% of GDP in 2009.

Such a rapid reversal has taken a toll on the prime minister's reputation, not least because (like Britain's Gordon Brown) he was formerly finance minister. He is struggling with three problems from a politically weak position. First is an economy in free fall, second a dramatic loss of support and third the vexed issue of Ireland's future in the European Union.



In June the Irish rejected the Lisbon treaty in a referendum. Yet 24 of the 27 EU members have ratified the treaty, and the Poles and Czechs (whose constitutional court has just cleared the text) are ready to do so. At next month's EU summit, Mr Cowen will report on his intentions. The French EU presidency wants an agreement that Lisbon should come into force by 2010, meaning that Ireland must hold a second referendum, probably next autumn. The carrots will be special declarations and derogations, plus a promise to keep one EU commissioner per country. To ease voters' fears on defence, the government could quit the European Defence Agency and opt out of a common defence policy.

When the Fianna Fail-led coalition that had been in power since 1997 was elected to a third term last year, its perceived economic competence was decisive. The government has now lost that reputation. Its poll ratings have dropped to the lowest in 25 years: only 18% are satisfied with the government's performance, and just 26% with Mr Cowen's. The decline owes much to a botched 2009 budget. Public anger at many spending cuts forced a reversal of some, at great cost to the government's credibility. The coalition still has a comfortable parliamentary majority, but it lost three supporters over the budget.

Against this background, how can Mr Cowen seriously hope to win a second referendum on Lisbon? A recent poll in the *Irish Times* offers mild encouragement. If Irish concerns on keeping their own commissioner, neutrality, abortion and tax are dealt with, a majority of 52.5% would vote yes. Yet that is still narrow; and initial leads for the yes camp in previous referendum campaigns on the EU have often vanished.

Mr Cowen may take more comfort from post-vote research pointing to public ignorance about the Lisbon treaty. One-third of voters believed that it included conscription into a European army and an end to Ireland's ban on abortion. Yet even if he dismisses such canards, it is hard to see Mr Cowen, who failed to sell Lisbon to voters when he and his government were popular, succeeding next autumn. He will find it difficult to stop a vote turning into a referendum on his government. Indeed, some argue that the Irish will say yes only if they believe that a second no would lead to their country's ejection from the EU—and that is itself a canard.

Italy's heritage

Underneath the arches

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From The Economist print edition

A man from McDonald's takes over Italy's heritage

"I'M ONLY here to help," pleads Mario Resca. "I'm here to serve the country." His problem is that he has been asked to serve culture. And, for 12 years, he served burgers. In a few days' time, this former boss of McDonald's in Italy will be put in charge of 3,600-odd government-run museums and archaeological sites. His appointment by Silvio Berlusconi's heritage minister, Sandro Bondi, has both astonished and divided Italy's cultural panjandrums.

Some welcome the idea of an experienced manager in a field that cries out for better management. Italy's best-known art critic, Vittorio Sgarbi, has called the choice of Mr Resca "very positive". But the advisory National Heritage Council has deplored the reorganisation that created his post. "Running a big factory and Italy's museums are not the same thing," sniffed the council's president, Salvatore Settis.

Mr Resca admits that he is no expert on art or archaeology, but notes that he also knew little at first about other businesses he has run. "My role is not to challenge the specialists, but to add value," he says. Yet doing this without clashing with the experts could prove difficult, given the competing demands of exploitation and conservation.

Italy's heritage is badly managed. Some of its museums are unwelcoming places with poor facilities. The most popular, the Uffizi in Florence, came only 21st in a 2007 world ranking, with just 1.6m visits. Yet attractions that are more popular are not necessarily well conserved. The ruins of Pompeii drew 2.6m visitors in 2007, but such is the dilapidation at the site that the government has declared a state of emergency.

The very name of Mr Resca's new department emphasises *valorizzazione*, or value-adding. "What I would like to do is to leverage what we have and make the visitors' experience better. We have to protect what we have, but we have to attract more people," he says.

His use of words like "leverage" and his description of the country's heritage as an "asset platform" are unlikely to endear him to critics. But they may take comfort from his enthusiasm for team-building and his reluctance to define a programme before taking the job. "I like to listen first," he says.

Charlemagne

Europe's surprising labour flexibility

Nov 27th 2008
From The Economist print edition

How migrating workers from eastern Europe are improving labour markets

Illustration by Peter Schrank



BY THE best guesses of Polish diplomats, a couple of thousand Poles lived in Ireland at the start of 2004, including 200 émigrés left from the second world war. Three years later Ireland was home to more than a quarter of a million Poles, according to consular estimates. This would be a startling change anywhere. It has transformed Ireland, a country of 4m which has long thought of itself (in the words of Ruairi Quinn, a Labour Party politician) as "an island off an island off the coast of the continent of Europe".

The change had two causes. One was a boom that began in the 1990s. The other was Ireland's enlightened decision to throw open its labour market when eight east European countries joined the European Union in May 2004. Ireland was one of only three countries (Britain and Sweden were the other two) from the old EU to open its labour markets from day one. A mass of evidence suggests that Ireland was rewarded for its openness, as its "Celtic Tiger" economy boomed on.

Since then foreigners have come to make up 15% of Ireland's population. The influx has helped to restrain wages even as unemployment sank to historic lows of under 4%. The new arrivals have also provided a big boost to domestic demand, as they shopped, ate and rented homes (thereby, less happily, helping to fuel a monstrous housing bubble). If anything, the Irish squandered the new immigrants' real potential: too many foreign graduates were left waiting on tables.

To Ireland's credit, however, society has stayed pretty calm in the face of change. There is no anti-immigrant party of note in Ireland. Tensions have centred on marginal issues, such as worries about non-English-speaking children in schools, or drink-driving easterners. It helps that the Irish have long memories of emigration and that the newcomers have spread countrywide, so that almost everyone knows a Pole. It is also true that Poles, being fair-skinned, family-loving Roman Catholic north Europeans, do not pose a huge test of Irish prejudices.

But Ireland now faces a vicious recession. The latest quarterly figures record the first annual fall in employment since 1991. Unemployment has jumped to 7% and will rise further. Ireland last had such a savage recession 20 years ago. Back then, Irish workers, including many young graduates, reacted as their forebears had: they left. The 1980s were "heartbreaking", recalls Alan Barrett of the Economic and Social Research Institute (ESRI), a think-tank. And one of the "greatest positives" of the boom was the idea that Irish people could return to rewarding careers at home. If significant numbers of Irish now have to emigrate again, it will be "very painful", both politically and culturally.

In truth, with the economic crisis hurting such traditional boltholes as Britain, America and Australia, as well as newer hotspots like Dubai (see article), the options for laid-off Dublin lawyers or builders from Cork are limited. For now, though, things look brighter for those from Eastern Europe. Polish banks may be shedding staff, but this is a good time to be a Polish engineer or builder of big infrastructure. A torrent of EU regional aid is about to hit the ex-communist countries: across eastern and central Europe there are plans for new airports, fast trains and motorways. Poland has stadiums to build for the European football championship in 2012. The Polish and Lithuanian governments are actively trawling for workers in Ireland.

Think-tanks like the ESRI now forecast a net outflow of migration from Ireland of some 30,000 over the year to next April. Harder numbers are difficult to come by: Ireland is not a police state, and seasonal workers are tricky to monitor. Some emigrants will be Irish, or non-EU nationals. But the political significance is clear: if 20,000 workers from eastern Europe left Ireland, that would reduce unemployment by about a percentage point. Departing Poles would take their spending power with them, admittedly. But on balance, if they leave, it will be another reward for open labour markets. For the first time, a jump in Irish unemployment may be offset by non-nationals leaving the country.

In the most optimistic scenario, skilled Poles, Balts and others will head home to wait out the storm, finding secure (if lower-paid) jobs there, but then return when Ireland picks up again. This would be a big step forward for Europe as well. For such dynamic and flexible migration has been an economic grail in the EU for years, as politicians looked enviously at Americans' willingness to move from one state to another in search of work. (In contrast, EU countries that impose curbs on foreigners give migrant workers already in them a reason to stay during downturns, for fear that it will be hard to return.)

And if they stay?

Yet an alternative prospect also haunts advocates of open borders: that Poland and other eastern countries slide into recession, encouraging migrants to stay in Ireland on welfare. Ireland has never hosted large numbers of foreign unemployed before. The employment minister, Billy Kelleher, predicts that many easterners will go home. They are not like the Irish or Poles who moved to America decades ago, knowing that it was a decision for life, he says. Today, Poland is but a budget-airline flight away.

On the ground, the first signs are mixed. Krystian Boino, a Polish lawyer, works for an advice centre in Dublin. There is no exodus, but plenty of construction workers are losing jobs, he says. Some want advice about Irish benefits. Others say they miss their family or friends, and treat a loss of work as a sign that it is time to go home, rather than to look for another job in Ireland.

The next few months will be telling. For Europe, little of cheer may come from the current economic crisis. But with luck, there will be visible rewards for several EU countries, besides Ireland, that have extended a welcome to hard-working foreigners who just wanted a chance to get on. If that happens, both the hosts and the workers will deserve to reap the benefits.

Fiscal stimulus

Coming soon to a screen near you

Nov 27th 2008
From The Economist print edition

The fiscal stimulus may look enticing, but the unadorned subplot is soaring debt

EPA



MORE heavily trailed than a Hollywood blockbuster, the government's fiscal package went on general release this week. Despite the hype, it lived up to expectations, though not in the way that Gordon Brown and his chancellor, Alistair Darling, had hoped. What caused a sharp intake of breath when Mr Darling announced their plans on November 24th was not the size of the much-vaunted fiscal stimulus designed to mitigate the recession. Rather, it was the sheer quantity of money that the Treasury will need to borrow in the years ahead.

Mr Darling's measures sounded impressive. The centrepiece was a temporary reduction in the main rate of value-added tax (VAT), charged on most goods and services, from 17.5% to 15%. Lowering the rate from December 1st until the end of next year will cost the exchequer £12.4 billion ($19 billion), worth 0.8% of GDP.

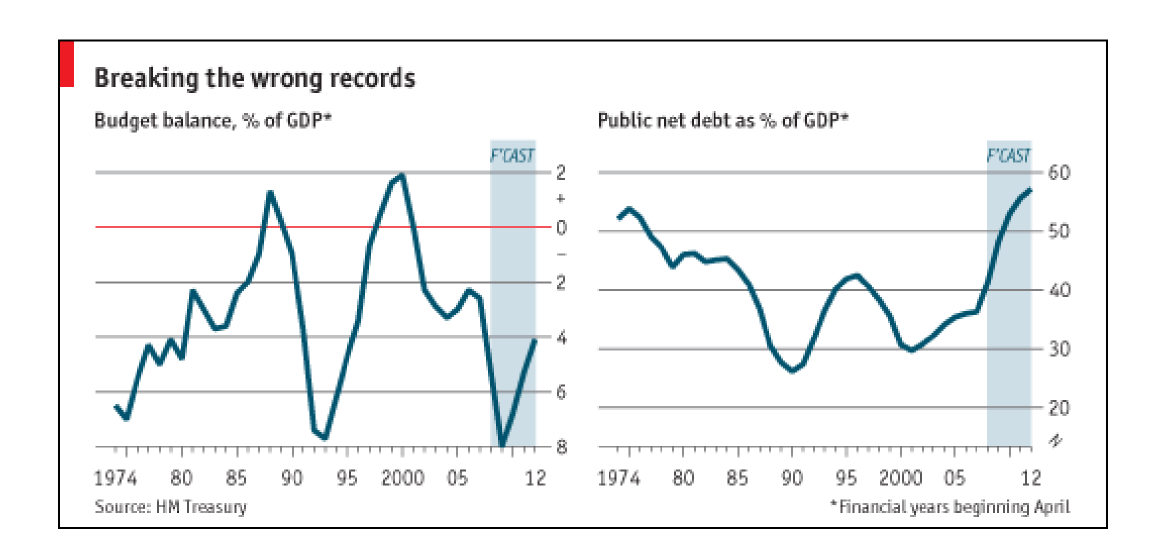
Mr Darling had much more to say, as he sought to highlight Labour's readiness to play an active role in supporting the struggling economy. There were measures to help business, such as the decision to defer until April 2010 an increase from 21% to 22% in the small-firm corporation-tax rate that was planned for next year. He also sprinkled money on Labour's long-favoured groups, pensioners and families with children. And he made further amends for the blunders of Mr Brown's final budget, which left over 5m families out of pocket when it came into effect in April. The compensation announced in May—a rise in the income-tax personal allowance—will be made permanent and more generous.

Adding up all Mr Darling's measures since the spring budget, the government will give away £9.3 billion more—0.6% of GDP—in 2008-09 than it planned in March, and £16.3 billion more—1.1% of GDP—in 2009-10. As the chancellor had already decided to hand out £4 billion, mainly through his help for poor families in May, his new measures for this financial year and the next amounted to £21.5 billion, including £3 billion of capital spending brought forward from 2010-11.

The case for fighting this recession through fiscal as well as monetary easing is a strong one, given that interest-rate cuts are not so effective if banks are reluctant to lend (see article). The advantage of cutting VAT is that it can be done immediately. And, because the cut is temporary, it gives consumers an incentive to spend more money over the next year, when the economy is expected to be at its weakest.

But consumers are likely to set aside some of these savings on their purchases. And a big chunk of the extra spending will go on imports. That is why Mr Brown is keen on a co-ordinated fiscal easing, so that exporters can benefit from extra demand in Britain's main trading partners.

Because of these leakages, the budgetary boost will moderate the economic downturn to only a limited extent. According to the National Institute of Economic and Social Research, it will mean that the economy shrinks next year by 1.2% rather than 1.5%. If similar boosts were made in the euro area and America, says the think-tank, British GDP would decline by 1%.



But if the prime minister would have liked to do more, the Treasury's answer, spelt out in perturbing new projections, was that government was pushing at the limits of affordability. Public borrowing is now set to soar by far more than the fiscal boost, rising from £37 billion in 2007-08 to £78 billion in the current financial year, and to £118 billion in 2009-10. By then it will be 8% of GDP, higher even than in the early 1990s and mid-1970s, when the public finances were similarly blighted. Net debt will rise from 36% of GDP in 2007-08 to 57% in 2012-13, again the highest in four decades (see chart).

The big deterioration in the public finances reflects three main things. First, there is the normal cyclical effect of a recession in raising unemployment-related spending and reducing tax revenues. Second is the particular effect of a recession whose epicentre is in finance and property. These two sectors have been money-spinners for the taxman, accounting for half the increase in total receipts between 2002-03 and 2007-08; the Treasury now thinks that revenues from finance and housing will decline by 1.5% of GDP between 2007-08 and 2009-10. And third, receipts in the past few years have been pumped up by taxes on buoyant consumer spending. Even with the fiscal stimulus, the Treasury's central forecast is that consumption will fall by 1.25% next year. The subsequent recovery will be led by exports and investment, a necessary rebalancing but one less lucrative for the exchequer.

The new borrowing and debt projections have made Labour's two fiscal rules—to borrow only to invest, and to keep public debt below 40% of GDP—ancient history. With so much hanging on investors' willingness to fund the huge deficits, it was essential for Mr Darling to set out how he intends to bring the public finances back into shape once the immediate economic crisis is over.

As a political symbol, the decision to raise the top rate of income tax on earnings above £150,000 to 45% was most salient (see article). But this change, due in April 2011, will raise only £1.6 billion a year, according to the Treasury. A further £1.3 billion will come from whittling away the personal income-tax allowance for people earning more than £100,000, to take effect a year earlier. Much more will be raised from a half-point increase in national-insurance contribution rates from April 2011 for both employers and employees, which is expected to produce £5.4 billion.

These extra tax revenues, totalling over £8 billion a year, will be partially offset by other tax reductions, however, so the net increase in taxes will be only about £4 billion in 2012-13. Most of the recovery in revenues, which the Treasury expects to rise by 1.4% of GDP between 2010-11 and 2013-14, will occur automatically as the economy starts growing at a brisk pace and tax receipts increase even faster. And, as the Institute for Fiscal Studies, a think-tank, points out, that contribution to lower borrowing will be outstripped by a clampdown on public spending, which will grow in real terms by just 1.1% a year between 2010-11 and 2013-14, causing its share of GDP to fall by 2.5% over that period.

Mr Darling's plans for fiscal retrenchment may look tough, but he does not envisage a return to

“borrowing only to invest” until 2015-16. Furthermore, his projections rely heavily on economic recovery in 2010 and a return to quite sturdy growth. That has prompted some to suspect that swingeing tax rises will be needed to sort things out—a suspicion that was hardened when a Treasury document including a subsequent VAT rise to 18.5% was inadvertently posted on the web. Mr Darling’s projections look gloomy. The worry is that they may not be gloomy enough.

UnCommon drama

Rumpelstiltskin v The Undertaker

Nov 27th 2008
From The Economist print edition

A not very edifying duel in Parliament

ONCE there was a beard, but now there are only the formidable eyebrows. They remained sombrely unarched as Alistair Darling delivered his pre-budget report on November 24th. Across the dispatch box, George Osborne, the shadow chancellor, pointed angrily at Mr Darling and his boss, Gordon Brown, his fingers sometimes joined for an angry karate chop. And yet fulminating Mr Osborne said little, and somnolent Mr Darling more than he can ever have expected.

Throughout his long cabinet career and short stint at the Treasury, Mr Darling has specialised in neutralising calamities. So he was better prepared than another might have been for his role in one of the most important and electric parliamentary events in recent years. He told of unimaginable borrowing and once-unthinkable tax hikes, all in a voice as unmodulated as an automated message.

Mr Osborne had all the best lines. He lambasted Labour's "decade of irresponsibility"; he compared the government, in its addiction to borrowing, to the "gambler who can't give up". He mostly avoided the flippancy that sometimes undoes him, and seemed authentically indignant. But for all the vigour of his critique, he offered almost nothing by way of alternative economic policy.

Mr Darling and Mr Osborne are opposites in more than party allegiance. Mr Darling is probably nearing the end of his bout in high office and Mr Osborne is yet to begin his; Mr Darling is understated and courteous—he is one of those politicians who is said to be funny in private—whereas Mr Osborne is flashy and occasionally vicious. But they have two things in common: both have recently been rumoured to face demotion—and both have survived, because both are essentially avatars for their bosses.

To sack Mr Darling would be for Mr Brown to admit the economic mistakes that the new chancellor inherited from him; Mr Osborne is the co-architect, with David Cameron, the Tory leader, of the new Conservatism (Mr Cameron always gives Mr Osborne a little pat when he sits down in the Commons, like the encouraging captain of a school debating team). So it is fair to assume that their exchanges on November 24th set the tone for the economic debate ahead. One side will be excitable, critical and hollow; the other will face down appalling news and repeat unreassuring mantras (the trouble came from America, and so on): Rumpelstiltskin versus The Undertaker.

After Mr Darling and Mr Osborne came Vince Cable, the Liberal Democrats' shadow chancellor. Since Mr Cable has been the most perspicacious of all senior politicians over the financial crisis (not that his party's poll ratings have benefited), the chamber hushed to hear him. He said the situation was even worse than Mr Darling admitted.

Banks and the real economy

Arm's length

Nov 27th 2008
From The Economist print edition

How hard should the state lean on banks to lend?

“OUR advice to members is don’t go to your bank,” says Stephen Alambritis at the Federation of Small Businesses. “They’ll assume you’re in trouble” and reduce your credit line, he cautions. In a poll by the Forum of Private Business (FPB), 47% of firms said their banking fees had risen since September, and 43% that the conditions attached to loans were worse than expected. Both groups are collecting data before meeting bankers and government officials on December 8th.

This is the anecdotal evidence facing the government as it ponders how to make banks keep lending to the real economy, and especially to small businesses. It is the single most important step towards economic recovery, the governor of the Bank of England, Mervyn King, told a parliamentary committee on November 25th. A bigger bail-out might be needed, he suggested, than the £37 billion ($57 billion) already pledged to bolster bank capital and £450 billion in guarantees and liquidity support. If that didn’t do the trick, nationalisation could not be ruled out, he agreed.

A day earlier Alistair Darling, the chancellor of the exchequer, unveiled a pre-budget report that included £1 billion of government guarantees for small-business loans and another £1 billion to underwrite export lending. A new panel is to keep an eye on bank’s lending practices.

Bankers protest that they have maintained lending at 2007 levels, a condition of getting a shot of new capital from the state. Figures from the British Bankers Association (BBA) show that bank credit to small businesses in particular grew by 10% in the 12 months to September. But many firms complain that their banks have not stuck with them. Loan and overdraft terms are changed, apparently arbitrarily, and sound companies with cashflow problems get nowhere when they ask for help.

Royal Bank of Scotland (RBS), which is about to get a £20-billion capital injection from the government, made headlines on November 23rd when it said it would offer small firms 12-month overdrafts at fixed interest rates that are not repayable on demand. “We will not pass on any increase in our cost of funds,” says Peter Ibbetson, head of small business at RBS. HBOS, likely to merge soon with Lloyds TSB with state support, says it already fixes rates for 12 months on small-firm overdrafts.

But policymakers are worried that most banks are too busy bolstering their balance-sheets to worry much about lending. October figures from the BBA show an unprecedented £50 billion month-on-month increase in bank loans to “financial companies”. These transfers, experts say, would include the refinancing of bad assets in the banks’ own structured investment vehicles (SIVs). Meanwhile, the number of new bank loans for housebuyers was 52% lower that month than a year earlier. A report on November 24th by Sir James Crosby, asked in April to study mortgage finance, predicted that next year banks could take more in from mortgage repayments than they give out in loans.

So far Mr Darling and Mr King have relied on jawboning to try to persuade banks to use the billions they have received in state aid to back more lending. As the recession gathers speed, however, bankers are increasingly concerned about their capital cushions. There is little officials can do to change that without grabbing the levers of power: board representation and voting rights. That appears to be anathema to a government that presided over a decade of financial liberalisation. Instead, it has set up UK Financial Investments, to run its shareholdings at arm’s length.

But political pressure is growing for more direct intervention. Sir James urged the government to rescue the market by guaranteeing securitised bank mortgages. To the surprise of many, Mr Darling told Parliament this week that he would work on a detailed scheme to do just that.

Lap dancing

Good clean fun

Nov 27th 2008
From The Economist print edition

A growing business, but perhaps not for long

SEXUAL titillation, said Simon Warr confidently on November 25th, is not the point of a lap-dancing club. Mr Warr should know: besides being the head of Britain's Lap Dancing Association, a lobbying outfit, he is co-owner of Spearmint Rhino's European operations, which include eight clubs around Britain.

Unfathomably, though, Mr Warr's audience—the House of Commons Culture, Media and Sport Committee—were not convinced. Nor was his case helped when Peter Stringfellow, a tycoon of adult entertainment, piped up. "Of course it's sexually stimulating," he said, but, he argued, so are discos and pictures of David Beckham in his underwear.

The MPs were pondering the Licensing Act of 2003, which changed the rules for many sorts of night-time entertainment. Most famously it allowed pubs to stay open all night. By abolishing the old 11pm rush, ministers hoped to promote a more restrained drinking culture, although critics feared it would merely encourage obnoxious revelry around the clock. In the event, British drinkers continued to behave about as barbarously as they had before, and few pubs have opted to stay open all hours.

But local councils and some women's-rights groups argue that, although drunkenness has not got worse, lasciviousness has. They blame the new rules for the swelling popularity of lap-dancing clubs, whose numbers have doubled to around 300 since 2004. Under the act, the clubs occupy the same legal category as other venues that offer dancing, such as cafés and bars. That means local bureaucrats (and residents) have little say about where they can be located. Campaigners want them classed with sex shops and porn cinemas, which face tougher restrictions. Club owners retort that classifying their joints as sex businesses may encourage punters to expect services that are not (officially) on offer.

Such arguments seem unlikely to cut any more ice with central government than they did with MPs. Ministers admit that treating lap-dancing clubs like staid coffee shops is a loophole, says the Local Government Association. Closing it would fit the more morally severe tone that the government has adopted since Gordon Brown (who is fond of pointing out that he is the son of a Presbyterian minister) became prime minister last year. Mr Brown has scotched plans for a giant casino drawn up under his predecessor, Tony Blair. There are plans to criminalise some men who buy sex, as well as fresh attempts to restrict drinks promotions in bars. Prudence may be dead, but Temperance is looking healthier by the day.



Arming the police

Zappers for coppers

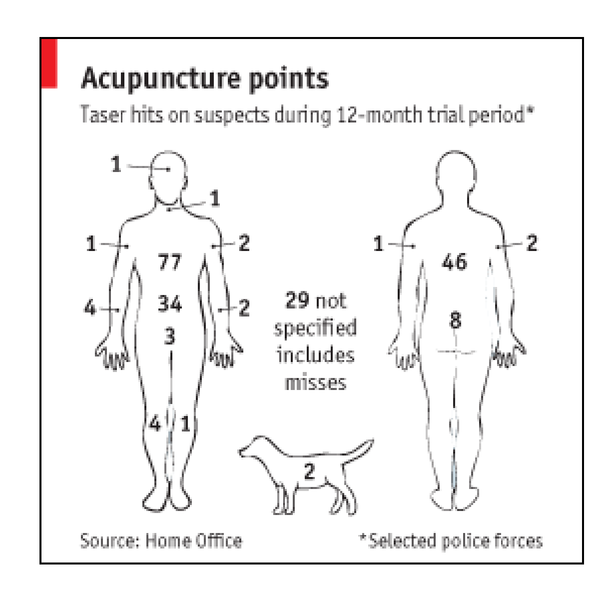
Nov 27th 2008
From The Economist print edition

Unarmed British bobbies get a new toy

AS WELL as the world's first modern police force, Britain has one of the gentlest. Fewer than 7,000 of its 140,000 officers are licensed to carry guns, and then only on authorised operations rather than on the beat. Now they are about to get tougher. On November 24th the Home Office announced plans to equip up to a quarter of officers in England and Wales with Taser stun guns, which until now have been available only to those trained to use proper firearms.

The weapons, which fire two barbed darts attached to 21 feet of wire and deliver a 50,000-volt shock, were introduced to British police in 2004 as a "less lethal" alternative to real guns. Last year their use was widened to include situations not deemed serious enough for bullets, though the weapons remained restricted to firearms officers. Now, police forces will be allowed to arm officers who have completed just a three-day course (rather than the weeks of training required of marksmen) and let them use the zappers whenever their safety or the public's is at risk.

Human-rights groups have long worried about Tasers: Amnesty International says that since 2001 more than 300 people have died after being zapped in America and Canada. Taser International, which makes the gadgets, says that other factors were to blame in all but a handful of these cases, in which it admits its device played a part. "I've taken about 400 hits and haven't a mark to show for it," claims Peter Boatman of Pro-Tect Systems, which has the rights to sell the £900 ($1,385) weapons in Britain. A government report judged that the risk of serious injury was very low, with the caveat that those who have taken drugs like cocaine could be at greater risk.



The roll-out follows a year-long trial in which officers recorded who was being zapped, and where (see chart). Of the 90 men, women and dogs who were stunned, five were children, the youngest 15 years old. (A Taser was also aimed, but not discharged, at a child of 13.) Of those people who had Tasers drawn on them, a fifth were judged by officers to be suffering from mental illness, and a similar proportion were thought to be on drugs—alarming, given that they may have been especially vulnerable to zapping. Twice that number were drunk.

No one was killed in the trial, but 64% of those who received shocks were injured, mainly by the metal barbs (one, lodged in a thumb, had to be removed in hospital) or falls (including a broken jaw and a cut to the face requiring stitches). One in seven was taken to hospital.

Then again, some argue, it is better to be stunned than shot. But few in Britain, unlike America, die at the

hands of the police now. Over the past decade police marksmen in England and Wales have killed about three people each year, and injured fewer. The introduction of the Taser in 2004 appears to have had no effect on these small numbers (if anything, fatal police shootings have gone up slightly). Instead, Tasers seem to be used as a substitute for batons, or other brute force. Moving a violent prisoner from one police cell to another used to require eight heavily protected bobbies and a lot of grief, says one officer; now, the threat of a short sharp shock is enough to make most come quietly. The deterrent power is impressive: in the Taser trial, police found that merely drawing and aiming the weapon was all they needed to do in 85% of cases.

Still, not everyone is convinced, including some policemen. The Metropolitan Police has declined the government's offer of more Tasers, for now at least. At present it hands them out only to its firearms officers and some of its "territorial-support groups", the heavy mobs who roam around in white vans breaking up pub fights. Giving out more might harm relations with the public, senior coppers say. Other forces are keener, however: Northumbria police, which also took part in the trial, made its Tasers available to officers 24 hours a day and managed to discharge them more often than the Met, which has nearly eight times as many officers.

Policing in Northern Ireland

Man down

Nov 27th 2008 | BELFAST
From The Economist print edition

Four deaths in the line of duty unite two communities

THE still-new Police Service of Northern Ireland (PSNI) lost four officers in the early hours of November 23rd, in the biggest single loss of life the force has had. The deaths were not the result of an attack by dissident republicans like the Real IRA, though they keep trying. The policemen—two Catholic, two Protestant—were hurrying through heavy rain to help colleagues arrest a driver thought to be drunk when their car hit a wall and burst into flames. Exploding ammunition may have made the fire burn more fiercely: though wholesale violence ended a decade ago, police in Northern Ireland still need guns and armoured vehicles to do their job.

The tragedy has paradoxically drawn attention to the progress being made on policing, long an obstacle to the smooth implementation of power-sharing in the province. Unionists have been reluctant to switch responsibility for law and order from London to Stormont, where Martin McGuinness, a former IRA leader, is deputy first minister to Peter Robinson of the Democratic Unionist Party; Mr McGuinness's Sinn Fein, on the other hand, insists on nothing less. But peace, and a policy of recruiting equal numbers of Protestants and Catholics, are gradually changing the face of policing. The Royal Ulster Constabulary (RUC), drew its officers largely from the majority community, Protestant and unionist. Today, Catholics account for almost a quarter of the total at the new PSNI.

The personal stories of the four officers, too, show how communal identities in Northern Ireland are relaxing. Kevin Gorman, a recent graduate of police-training college, had moved to a largely Protestant town but still played Gaelic football for his native Drumaness. (Until 2001 the Gaelic Athletic Association refused membership to the "British security forces", lifting the ban only when the new police service emerged.) Part-time policeman Declan Greene also played Gaelic football, but in his day job he worked in a factory along with Constable Kenny Irvine, an active Orangeman. The Orange Order forbids members to marry Catholics or attend Catholic services.

In the past few days, both Protestants and Catholics have paid tribute to the fallen officers. Mr McGuinness was quick to express sympathy for all their families. A Catholic newspaper, the *Irish News*, reported the deaths over eight pages, setting them in the context of numerous RUC fatalities at the hands of the IRA. Jim Wells, a Democratic Unionist at Stormont, said that prayers would be said in "churches and chapels alike". Mr Wells is a fundamentalist Christian who deplores Roman Catholicism as unbiblical and chapels, with their statues and candles, as tinged with idolatry.

But all is not yet sweetness and light. As three police funerals took place on November 26th, members of the "Continuity IRA", the splintered dregs of republican paramilitarism, threatened to kill Catholic community workers in Belfast for working with the police against drugs and minor crime. And on a higher plane, power-sharing continues to stumble forward, inch by painful inch.

Welfare reform in a recession

Pressing on

Nov 27th 2008
From The Economist print edition

A tougher deal for lone parents goes ahead, despite criticisms

"IN place of welfare", intoned Gordon Brown promisingly in his first budget as chancellor of the exchequer in 1997, "there should be work." Efforts to get Britons off benefits and into employment have been fitful since then. But most of the reforms—such as the New Deal, a "workfare" scheme launched a decade ago, Jobcentre Plus, a new kind of dole office focused on helping claimants find jobs, and the introduction of various in-work benefits—at least enjoyed the tailwind generated by a booming economy.

Now, with unemployment rising, some worry about the timing of the latest round of reforms. On November 21st Sir Richard Tilt, the chairman of the social-security advisory committee, a statutory body, called for changes to benefits for jobless single parents to be delayed. On November 24th, single parents whose youngest child is aged 12 or over began to be shifted over to job-seeker's allowance, a benefit that requires the recipient to be looking actively for employment. That age cut-off is scheduled to fall further, to ten years in 2009, and seven in 2010. Previously, lone parents were able to claim income support until their youngest child reached 16.

A recession is hardly the time to require claimants to look for work, says Sir Richard, who fears that the sanctions for not doing so (including benefit cuts of up to 40%) could push more children into poverty. He cites good reasons why many single parents are jobless, such as the scarcity of affordable child care. Yet these are hardly callous reforms, insists James Purnell, the work and pensions secretary. Lone parents will not be forced to take just any job, and the interests of their children will be taken into account. The point is to ensure that claimants are at least looking and preparing for work. Far more radical changes can be found elsewhere in the government's welfare-reform package, such as using private-sector and voluntary contractors to help the long-term unemployed back into work, and medically reassessing all 2.6m of those who claim incapacity benefit now, many of whom are thought to be capable of working.

The moral qualms about the government's plans for single parents may be overdone: ministers point to social-democratic Scandinavia, where job-seeking requirements of lone parents are much tougher. But there are practical obstacles in Britain that must be taken seriously. With unemployment at an 11-year high, job centres may soon be too busy to provide effective personal support to those looking for work—and indeed, in the expectation of a rush, the government announced a moratorium on planned job-centre closures on November 25th, as well as cash for more front line staff. Even more worryingly, those hoped-for private contractors may now balk at the prospect of being paid only if their charges find work and keep it.

Whatever the challenges posed by a bleak labour market, only the most withering setbacks are likely to weaken the government's commitment to welfare reform. This wasn't always the case: Mr Brown was initially contemptuous of the recommendations of David Freud, a former banker commissioned in 2007 by Mr Brown's predecessor, Tony Blair, to review welfare policy. It was only after the Conservatives' own Freud-inspired plans scored well in opinion polls when they were unveiled in January that Mr Brown was converted to the cause.

In Mr Purnell, he has an enthusiastic champion of welfare reform and other Blairite policies. And in the Tories, he has an opposition that supports the thrust, if not every detail, of the government's plans. America's welfare reforms of 1996, often brandished as proof of what can be achieved elsewhere, took place against the backdrop of a benign economy and relative political consensus that radical change was needed to take on an entrenched dependency culture. Mr Brown will have to manage without the former, but, when faced with the kind of criticism provided by Sir Richard, he can count on the latter.

Bagehot

Pinch the rich

Nov 27th 2008
From The Economist print edition

The rich are the new whipping boys of British politics. But they are less friendless than they seem

Illustration by Steve O'Brien



A LOT of energy is expended by British think-tanks and sociologists on identifying the poor. Less attention is paid to classifying the rich. Public policy has haphazardly offered some pointers, by setting thresholds above which Britons are considered undeserving of state support, vulnerable to inheritance tax and so on; but hitherto these signals have not added up to a clear definition of richness. Most well-off people instinctively resist the idea that they are rolling in it: the rich are always different, elsewhere, someone else. So perhaps it is helpful of Alistair Darling, the chancellor of the exchequer, to have offered a clear typology of wealth in his emergency budget on November 24th.

You are very rich, the chancellor implied, if you earn more than £150,000 ($230,000) a year. You are still rich if you earn more than £100,000. He told the very rich—around 400,000 taxpayers, roughly 1% of earners—that from 2011 they will pay a new top rate of income tax of 45% (the current top rate is 40%), on earnings above £150,000. Both groups—around 800,000 people altogether—will pay more tax from 2010, through the erosion of their tax-free allowances. Meanwhile, anyone earning over £40,000 is, in the government's view, comfortable enough to cough up a few pounds extra in national-insurance contributions (though according to a rival arithmetic, £20,000 marks the real cut-off between winners and losers under the new arrangements).

Two questions arise from Mr Darling's delineation of this hierarchy—and the jettisoning of New Labour's iconic pledge not to raise income tax, a promise that has helped to win it three general elections. First, does it make sense for the exchequer?

The government's case, though Mr Darling didn't put it quite like this, runs as follows. Britain is broke; in the medium term, taxes have to rise. In a country where median full-time earnings are £24,900, people making four times that much or more ought to help fill the fiscal abyss. And although this is the first lift in the top rate of income tax for more than 30 years, it is scarcely a confiscatory levy like the legendary rates of the 1970s, when Old Labour dinosaurs roamed the Treasury.

The trouble with this argument is that the hikes will raise barely any money. The 45% rate will yield little according to the Treasury, and practically nothing according to some analysts, because of dodges and disincentives. Rather than budgetary pragmatism, the changes seem to be the fiscal equivalent of a

firework set off during an earthquake—the earthquake being Mr Darling's staggering debt projections, his Panglossian growth forecasts and a public-spending squeeze of a kind Labour once excoriated. It is fair to conclude that the real motive is diversionary and political.

Thus, the second question: is pinching the rich quite as politically clever as the government evidently believes?

Pinch yourself

The political calculation seems to be that, after 11 years in office, Labour is no longer dogged by memories of the vengeful taxes and fiscal incontinence of its previous stint in power, historical anxieties that constrained its tax policy until now. That hunch may be justified: many young voters are more likely to associate Labour with persistent inequality than with IMF bail-outs. But another part of the gamble is that the country has changed too: that the incipient recession has fostered a new mood of social solidarity, a yearning to "share the pain" of the downturn—particularly if the pain is aimed at bankers and other much-loathed "spivs and speculators". Satisfying this mood with token raids on the rich, Labour reckons, will win more votes than will be lost by severing its already frayed bond with the City. The hikes may cost it a few marginal seats in the stockbroker belt of the south-east, but they will firm up ratings farther north.

Mr Darling, and his boss, Gordon Brown, are not alone in sniffing a new political atmosphere. Even before this week's emergency budget, some in the Conservative Party, no less, muttered about proposing a new supertax and using the proceeds to cut rates for the middle classes. The Tories now say that should they win the next election (more likely than not), and have scope for tax-cutting (rather less likely), the first beneficiaries would be businesses and those on low and middle incomes; reversing Mr Darling's higher-rate changes would "not be a priority". The poor rich are suddenly friendless.

Or are they? The rich may be a tiny minority, but they are not altogether alone. Indeed that was, or appeared to be, one of the basic intuitions that took New Labour to power.

New Labour's original tax pledge was a totem of its revamped economic approach: of its acknowledgment that free markets and deregulation were, after all, the best way to maximise national prosperity and finance progressive goals. But it also implied an even greater admission: that Britain was more individualistic, more aspirational and less collectivist than Labour had previously believed. The pledge seemed to concede that Margaret Thatcher had been right about not only economic policy but also the national personality; that Britons might resent inherited privilege but were increasingly relaxed about wealth itself. New Labour realised that whereas the rich are few, the would-be rich—likewise alarmed by punitive taxes—are numerous.

It now appears that for Mr Brown and Mr Darling, at least, New Labour's old posture on tax may not have represented the fundamental reappraisal of Britain's psychology that it did for Tony Blair; that for them it was a necessary economic and electoral strategy, not an imaginative epiphany. Perhaps they are right about the new mood: Number 10 doubtless spent almost as much as the new taxes will extract on testing their popularity in focus groups. But it may be that the country has changed less than Mr Brown thinks, and that even in a slump the rich are less isolated than they look. More than an economic crime, pinching the rich may turn out to be a profound political mistake.




Smoking, governments and health

A wisp of public-spiritedness

Nov 27th 2008
From The Economist print edition

Tobacco firms want the right to participate in global efforts to limit the lethal consequences of nicotine addiction—but 160 governments say no

The Advertising Archives



SOME people would say it was tantamount to foxes asking to be consulted about the welfare of chickens. But the global tobacco industry, while no longer denying that its products do terrible damage, has long insisted that in any discussion about how to limit the medical effects of the weed, it is a legitimate partner.

That claim was emphatically rejected by health officials from 160 countries after a week's deliberation in South Africa which concluded on November 22nd. In a statement that grew steadily tougher in the course of the meeting—to the dismay of cigarette firms and the delight of their adversaries—it was proclaimed that there is a "fundamental and irreconcilable conflict" between the interests of the tobacco industry and the cause of public health.

In a non-binding but morally powerful set of guidelines, it was also laid down that interaction between governments and tobacco firms should be limited to what is "strictly necessary" and kept transparent through public hearings and disclosure of records; voluntary or non-enforceable arrangements should be barred. In other words, anything that could make tobacco firms look like decent citizens, doing their bit for public service, ought to be avoided.

Isn't the reference to "irreconcilable conflict" simply a statement of the obvious? Far from it, whichever side of the trenches you occupy. Tantalising but outrageous attempts to glamorise smoking through billboards and films may largely be a thing of the past, but these days the industry uses subtler tactics to burnish its image as a business that, despite everything, cares about its consumers. How much credence governments give these tactics is an important issue.

Critics claim that firms, while proclaiming their concern for health, use insidious methods to infiltrate and water down the efforts of the World Health Organisation to combat the scourge of tobacco. (It is a habit which by the WHO's calculation claims more than 5m lives a year—a figure that may double by 2030. In the latest piece of dire news about tobacco and health, a study in *The Lancet,* a British medical journal, says 100m Chinese men may die early from smoking between now and 2050.)

The countries that conferred in South Africa were all parties to the WHO's Framework Convention on Tobacco Control, the so-called global tobacco treaty, which commits signatories to stop the promotion of

smoking through advertising, and also to protect health policies from interference by the tobacco industry.

According to foes of the industry, such protection is hard to ensure. Especially in countries where governance is weak and people are poor, tobacco companies can make themselves useful by organising “conferences” where, for example, the value of advertising bans is mocked. And ministers can be induced to water down bans on smoking in public places by decreeing more areas where people can still puff away. In what critics call a subtle form of self-promotion, companies can engage in campaigns against “youth smoking” which actually serve to publicise their brands. In Zambia, for example, British American Tobacco (BAT), the second-largest player in the global business, has been involved in a campaign to stop the sale of cigarettes to people under 18.

And BAT, as it happens, was quick off the mark in denouncing the outcome of the South African meeting. It emphasised what may be one of the industry’s more plausible arguments in favour of being treated as a legitimate partner: the need to crack down on cigarette smuggling (as urged by the global treaty) which tends to rise as high taxes are slapped on tobacco (also recommended by the treaty).

The guidelines adopted in South Africa, so BAT complained, could ban most public communication by tobacco companies, minimise contact between them and governments and ban the display of tobacco products in shops. Such “extremism” would obstruct the efforts of the “legitimate tobacco industry” to block illegal sales to children, fight illicit commerce and invest in “safer” products. (For health advocates, the very idea of “safe” forms of tobacco is misleading.) Another proposal that won an approving mention at the South African meeting—plain packaging for all cigarettes—would help counterfeiters and smugglers, BAT says.

Some critics would say Big Tobacco has been a latecomer to the war against smuggling. In years past, the European Commission used to accuse well-known firms of colluding with smugglers by slipping them merchandise that was destined to enter the European Union illegally. However in 2004, the EU announced a deal with Philip Morris International, a global tobacco concern, under which the company vowed to pay $1.25 billion over 12 years and take a series of anti-smuggling measures. European officials at the South African meeting said they couldn’t fight contraband without at least talking to legal producers. (Other foot-draggers at the gathering were the governments of Japan and China, both of which have big stakes in the tobacco business.)

Europe’s filter-less frontiers

The war against smuggling will always be hard in rich parts of Europe where the retail price of cigarettes is many times higher than in nearby places like Ukraine and Serbia. In recent months, European customs officers have complained of a tidal wave of contraband cigarettes arriving from the Russian enclave of Kaliningrad.

But industry officials say an explosion of contraband in Canada—normally seen as a law-abiding place—is another example of what happens when regulation (in the form of high taxes and a ban on all displays in shops) is exceptionally tough. Nearly half the cigarettes smoked in Ontario are now illegal, BAT said in its response to the South African statement.

The United States is a conspicuous absentee from the WHO’s war against smoking. The tobacco treaty is one of many instruments of international law that America helped to design, only to hold off from ratifying it because of stiff opposition on Capitol Hill. For example, Richard Burr, a senator from North Carolina, calls the treaty a surrender of sovereignty which would punish the United States by forcing it to fund the lion’s share of a global anti-tobacco drive with no corresponding rise in influence. Moreover, he says, the drafters of the treaty refused to listen to the “producers of tobacco”—a sure sign that their purpose was not “to bring a safer product to market” but to eliminate the production of tobacco altogether.

On the last point, at least, tobacco’s sternest foes might concur with the senator. However, some American legislators have taken a different view. In 2005 a group of 11 senators wrote to George Bush urging him to send over the tobacco treaty for consideration; they noted that tobacco claims more than 400,000 American lives a year. One of the signatories was a senator whose appealingly husky voice may owe something to his own weakness for the weed—Barack Obama.

The UN, Israel and racism

At risk of early derailment

Nov 27th 2008
From The Economist print edition

Preparations for a new global discussion on race start to go wobbly

THE United Nations has high hopes of combating racial intolerance, and the violence it causes, with giant talkfests. One such gathering—a World Conference against Racism—took place in Durban in 2001. Preparations for a follow-up, to be held in Geneva next April, are in trouble. Two countries, Israel and Canada, have left the process; several others (all in the West) are threatening to do so unless the new meeting avoids the anti-Israel excesses which in their view marred the first one.

“Had we thought there could be some real value to this conference, we would not have walked out,” said Aharon Leshno-Yaar, Israel’s envoy in Geneva. “Israel must be in the forefront of any combat against racism. But the whole process has been hijacked by a group of radical countries wanting to shield themselves against criticism by heaping blame on the West.” Israel feared a repeat of the “hatred and extremism” that marked the 2001 meeting.

That gathering, with some 18,000 delegates, was certainly imperfect. A Palestinian *intifada* was raging and passions were high. The Israelis and Americans walked out early on, saying criticism of Israel was disproportionate. Europeans and other Westerners slogged on, finally producing an anodyne statement. Of 341 paragraphs, only six referred to Israel, the Palestinians, anti-Semitism or the Holocaust, none in an obviously objectionable way.

What gave the 2001 meeting a bad name, in the eyes of Israel and its friends, was the parallel NGO forum, whose final declaration was so strongly worded—equating Israel’s policies in the occupied territories with apartheid—that Mary Robinson, then UN High Commissioner for Human Rights, refused to endorse it or to transfer it to the main forum. In many minds, the two sessions—the official one and the NGO one—have become conflated into a single event, known by human-rights wonks as “Durban I”.

The whole thing was a “festival of hate and anti-Semitism”, says Hillel Neuer, head of UN Watch, a group that monitors the world body for perceived bias against Jews and Israel. He predicts the Geneva meeting will be just as bad. Its cause is not helped by the fact that it is being organised by the UN’s much-criticised Human Rights Council, with Libya chairing a preparatory panel that includes Iran, Cuba, Russia and Pakistan.

Some stridently anti-Israel views expressed by a group of Asian countries, and drafted mainly by Iran, have added to the mood of alarm. But the outcome of the 2009 meeting may prove less extreme. The Asian paper is just one of five regional contributions, none of which will see the light of day in its current form. Line-by-line haggling will start in January, with the aim of producing a much shorter final declaration with some hope of winning consensus.

When Canada left in January, it said it would not be “party to an anti-Semitic, anti-Western hatefest dressed up as an anti-racism conference”. Israel followed on November 19th. America, Australia, France, Britain, the Netherlands, Poland, Slovenia and the Czech Republic may also quit unless things change. Others, like Germany, Spain, Austria, Belgium and the Scandinavians seem keener to try influencing the tone from inside.

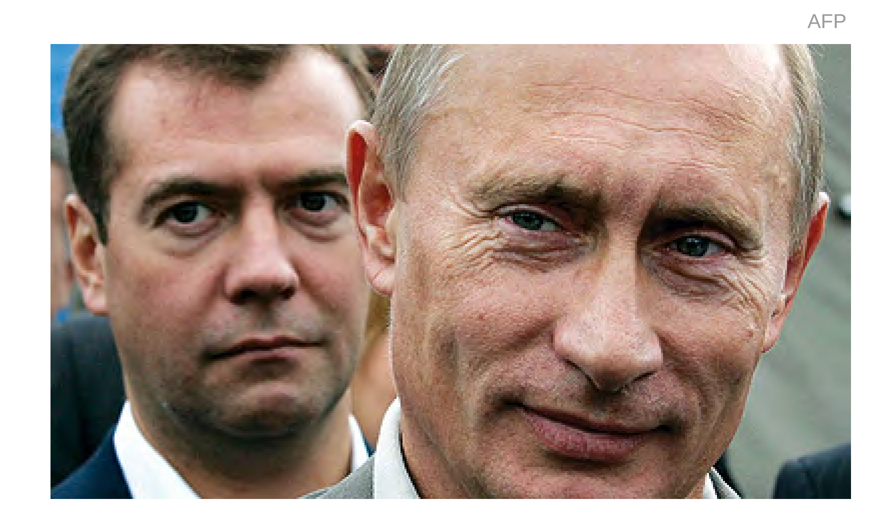
Some people question the idea of a global discussion of an issue as diffuse as racism. After all, they say, little was gained by the 2001 show or by anything that followed. Others, like Gay McDougall, an American who is the UN’s independent expert on minorities, disagree. She deems it significant that in 2001 almost all governments admitted that racism existed in their own societies, and notes that in 2009 countries will be held to account for pledges made in Durban; only then can the process be judged. Sceptics are unwilling to wait.

Enigma variations

Nov 27th 2008
From The Economist print edition

Russia is not the Soviet Union, but what is it? A recovering world power—or a corrupt oligopoly with a market economy of sorts? Arkady Ostrovsky (interviewed here) explains why it is both

AFP



ON DECEMBER 25th 1991 the Soviet flag above the Kremlin was lowered for the last time and the last president of the Soviet Union, Mikhail Gorbachev, made his resignation speech. “The totalitarian system has been eliminated...free elections...free press, freedom of worship, representative legislatures and a multi-party system have all become reality.”

A few hours later, America’s then president, George Bush senior, declared victory in the cold war. “For over 40 years the United States led the West in the struggle against communism and the threat it posed to our most precious values...That confrontation is now over. The United States recognises and welcomes the emergence of a free, independent and democratic Russia.”

The collapse of the Soviet empire was inevitable, rapid and largely bloodless. In its aftermath the world watched, with a mixture of hope and despair, the emergence of a new country that turned out a lot less free and democratic than advertised. Confrontation with America did not disappear but took on a new meaning.

In early August this year the Russian army, for the first time since the Soviet collapse, crossed an internationally recognised border and fought a short, victorious war: with Georgia. Russia’s leaders said they were defending two breakaway territories, Abkhazia and South Ossetia, from Georgia’s aggression. But at home they also hinted that this was a proxy war with America which had tried to muscle its way into what Russia calls “the region of privileged interest”. It was a defining moment for Vladimir Putin, Russia’s president until the election in March this year of Dmitry Medvedev and still the man who, from his new job as prime minister, holds the reins of power.

To many, the conflict brought back memories of the cold war and portrayed Russia as a Soviet Union mark two, trying to regain its former territories. All the signs appear to be in place: Russia is ruled by former KGB men like Mr Putin who see enemies everywhere; its political opposition is crushed; independent journalists occasionally get killed; and the state media pump out anti-American propaganda. Once again military parades are being held in Red Square. And in his belligerent state-of-the-nation address on November 5th Mr Medvedev threatened to station short-range missiles in the Kaliningrad region, aiming them at Europe, unless America backed off from its plan to put a missile-defence system into eastern Europe.



But the parallels with the cold war are misleading. Russia is not the Soviet Union. It does not have a communist (or any other) ideology, nor does it have much faith in central planning. It has private businesses, a free market of sorts and a great taste for consumption. Russian firms are listed on foreign stock exchanges. Their managers fly business class to factories in the Urals, read financial newspapers and labour over spreadsheets on their laptops.

Members of the country's elite have many personal ties with the West: they own property in London, send their children to British and American universities and hold foreign bank accounts. But none of this stops the Kremlin from being anti-American and autocratic.

So far the state has not interfered in people's personal lives. It gives them freedom to make money, consume, travel abroad, drive foreign cars and listen to any music they like. They are even free to criticise the Kremlin on radio, in print and on the internet, though not on television. And although Russia's elections are stage-managed, the support for Mr Putin is genuine. During the war in Georgia it hit almost 90% in opinion polls. The biased television coverage plays its part, but unlike Soviet propagandists, who told people what to think, Russian propagandists tell people what they want to hear, says Georgy Satarov, who used to be an aide to a former president, Boris Yeltsin, and now runs INDEM, a think-tank. What people want to hear, especially as they are getting richer, is that their country is "rising from its knees", sticking its flag in the Arctic Circle, winning football games and chasing the Americans out of Georgia.

Mr Putin has positioned himself as the symbol of a resurgent nation recovering from years of humiliation and weakness. In fact, few Russians in the 1990s brooded on such feelings; most were too busy getting on with their lives. But there was one group that had good reason to be aggrieved: members of the former KGB. When Mr Putin came to power in 2000, they projected their views onto the whole country. America's hawkishness towards Russia made their job easier.

Mr Putin also accurately sensed and cleverly exploited nostalgia for Soviet cultural symbols. One of the first decrees of his presidency in 2000 was to restore the Soviet national anthem. Soviet icons were revived not because of their connection with communism but as symbols of stability, continuity and power. A TV show, "The Name of Russia", based on a British programme, "100 Great Britons", lists Joseph Stalin as one of the country's five all-time greats. Most Russians associate him not with repression and terror but with the power and respect which their country once commanded.

"Our foreign policy is clear. It is a policy of preserving peace and strengthening trade relations with all countries…Those who want peace and seek a business relationship with us will always find our support. And those who try to attack our country will be dealt a deadly blow, to deter them from sticking their snouts into our Soviet backyard." Stalin made this speech in 1934, reflecting on a recent world economic crisis which, as he explained, "spread to credits and liquidity, turning upside down financial and credit relationships between countries…Amidst this storm…the Soviet Union stands separately, like a rock."

Similarly, in reaction to the current economic turmoil, Mr Putin declared the Russian economy to be a "safe haven" for foreign capital. On the other hand, "the trust in America as the leader of the free world and free economy is blown for ever."



A love-hate relationship

The paradox of Russia's nationalism is that its patriotic zeal closely follows the American model. One of the biggest pop hits in Russia a few years ago was a song called "I Was Made in the USSR", first performed in 2005 in the Kremlin, in front of Mr Putin. "Ukraine and Crimea, Belarus and Moldova—it is my country...Kazakhstan and the Caucasus as well as the Baltics—it is my country...I was born in the Soviet Union; made in the USSR," its lyrics go. As the audience rose to applaud, it was perhaps unaware that the tune was the same as Bruce Springsteen's "Born in the USA".

Konstantin Ernst, the boss of Russia's main TV channel, which churns out nationalistic, anti-American propaganda, worshipped Francis Ford Coppola, an American film-maker. These days he produces American-style blockbusters on a Russian theme and sells distribution rights in Hollywood.

The loudest anti-Americans in Russia are not the unreformed communists but the well-dressed, English-speaking speechwriters from the *perestroika* era. The Kremlin's confrontation with the West is based not on differences of ideology or economic systems but on the conviction that Russia is no different from America and that the West's values are no stronger or better than Russia's. Any public criticism by Western leaders of Russia's behaviour is therefore seen as deeply hypocritical.

America looms much larger in Russia's mind than Russia ever did in America's. To compete with America, Mr Medvedev even scheduled his recent state-of-the-nation address to coincide with the American election. Russia wants to be like America and follows in its footsteps. Unfortunately, says one American former official, "they followed our mistakes and not our system of governance."

Russia's war in Georgia and its unilateral recognition of South Ossetia and Abkhazia copied the West's recognition of Kosovo in the Balkans, even though only a few months earlier Mr Putin had said that unilateral recognition of Kosovo was "immoral and illegitimate". Conversations with Russian officials often end with the plaintive question: "What have we done that you haven't done?"

Igor Shuvalov, the first deputy prime minister and Mr Putin's right-hand man, was in London (where his son studies) when Georgia erupted. The war showed that Russia and the West are now cemented together, he argues. "It showed that all our values are exactly the same. Russia is a civilised country, we all want to live well, like ordinary Americans, we want to protect ourselves from external threats like you do...Perhaps we do not have such a sophisticated democratic infrastructure, but in essence American presidential elections are no different from ours."

The confrontation between Russia and the West is not about different values, he says, but about different interests, financial and geopolitical. "Friends are only friends until you start splitting the money. These [Western] countries need to have access to oil and gas, and to get it they are prepared to use any means, including accusations that Russia has a different system of values. All...Russia is doing is defending its interests. We want to live peacefully, but the West cannot tolerate the idea that we are an equal partner, that we are the same. Now there is no more time for niceties."

Yet although the Russian elite has adopted a Western lifestyle, it rejects key principles of Western governance. Lilia Shevtsova of the Carnegie Moscow Centre, a think-tank, argues that "hostility towards America and the West sustains the authoritarian and corrupt rule of the rent-seeking elite which portrays its narrow corporate interests as the interests of the nation." In Georgia, Russia was defending not so much the separatists but its own ruling class and its value system. By imitating and repelling America at the same time, Russia tries to ward off a hostile value system that includes democracy and the rule of law. The Kremlin sees its relationship with the West as a zero-sum game: if it resurges, America will decline.

A long way to go

A few years ago Mr Putin said Russia’s national idea was to be competitive. The Kremlin asserts that Russia has regained its status of “a mighty economic power”. Its goal is to achieve economic and social development which befits “a leading world power of the 21st century” by 2020.

This special report will draw attention to the many things that stand in its way. The country is beset by chronic and dangerous weaknesses. Its economy depends on natural resources and cheap credit, and its private business, which pulled the country out of the 1998 crisis, is constantly being harassed by the state. Corruption is so pervasive that it has become the rule. Russia’s population is shrinking by 700,000 a year. And its neocolonial methods of governance in the north Caucasus have created a tinderbox.

The gap between rich and poor is growing. Moscow’s exclusive outskirts look like American suburban shopping malls writ large, yet villages not far away lie abandoned. The rich and powerful are steeped in luxury, yet the average Russian earns a mere $700 a month. Russia is building pipelines to Europe but much of its own country has no gas or even plumbing. Russia’s “great leaps forward” have rarely benefited its own people, who have traditionally been seen as a resource. Most Russians grumble about their lives, but see “international prestige” as a consolation prize.

Russia has the potential to develop into a strong and prosperous nation, but the Kremlin’s nationalism, hostility towards the West and authoritarianism make the task more difficult. A two-minute video made by a Russian soldier captured in Georgia (now on YouTube) illustrates the point. As they smash up neat Georgian barracks, the Russians curse their own poverty and hail their victory in the same breath. “They [the Georgians] had everything,” one Russian soldier says. “They had nice barracks, good furniture, and we live like tramps. But they got screwed.”

The long arm of the state

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The financial crisis may lead to renationalisation by stealth

EVEN to someone who has never been to Yekaterinburg, a large industrial city in the Urals, the changes are obvious. Shiny towers of metal and glass have shot up everywhere without order or design, pushing aside historic buildings and making the Soviet-era apartment blocks look even grimmer. At night cranes are lit up like Christmas trees. At eight in the morning heavy traffic, mostly of foreign-made cars, chokes streets that still bear Soviet names. The city's ultra-modern airport makes Moscow's look shabby.

Yekaterinburg, traditionally the centre of the mining and metal-bashing industry, is a microcosm of Russia's economy. Until recently it has been flush with money, mostly from natural resources and cheap credit, spent in sprawling supermarkets, restaurants and car dealerships. Oil, gas and metals make up around 80% of Russia's exports, and until recently their prices were rising fast. For the past five years the economy has been growing at about 7% a year. Measured in dollars the rise has been much faster. Some of this money has been stashed away into a stabilisation fund, but a large portion has been fuelling an unprecedented consumer boom. Real incomes have more than doubled since 1999 and the growth in retailing has averaged 12% a year.

In a country so long starved of good restaurants, hotels and shops, it was natural that consumers should take a lead role, says Andrei Illarionov, a former economic adviser to Vladimir Putin and now one of his fiercest critics. Besides, there is so much uncertainty around that most people would rather spend than save.

But there has been plenty of capital investment too, though mostly in extractive industries. Fixed investment last year rose by a record 21% on the year before, although it remains relatively low.

Private initiative, freed up by the market reforms of the 1990s, became the main force behind Russia's economic recovery after the 1998 crisis. Growth was particularly strong in sectors that were not weighed down by any Soviet legacy, such as mobile telecoms. But private ownership was also transforming Soviet-era behemoths.

Proud to be private

One example is Uralelectromed, a large copper producer in the Urals, which is partly owned by Andrei Kozitsyn. In the past five years the company's revenues have tripled. It has used the money to install a new production line, along with the latest American equipment. To add value, it has begun to produce high-quality wire, which it exports to Europe. "We had to be competitive, otherwise we were meaningless," says Mr Kozitsyn. Having started as a worker in the factory, he rose to the top because he wanted to be in business. But these days, he says, young people prefer bureaucratic careers.

Tax revenues from his industry provide about 40% of the Ural region's budget. But the government has used the money to pay higher salaries to its employees, recruit more of them and renovate offices rather than build new roads and railway lines, which companies like Uralelectromed badly need.

Crucially, the government failed to use the good times to diversify the economy, clean up its banking system, reform capital markets, strengthen property rights and establish the rule of law. As long as the oil price was going up, nothing that Russia did—from the overt expropriation of Yukos, a giant Russian oil company, to forcing foreign oil companies out of production-sharing agreements—seemed to stop the flow of money into the Russian stockmarket. The job of raising capital was outsourced to foreign banks and capital markets. They lent money to state companies such as Gazprom and Rosneft whose debts were implicitly backed by the government.

This uncontrolled corporate borrowing undid the government's success at repaying state debt, building up foreign-exchange reserves and setting up a stabilisation fund in which to accumulate some of the oil

revenues. At the end of June Russia's total external debt was $527 billion. Its total reserves in November were $475 billion.

Mr Putin boasted that the net inflow of capital had reached $80 billion last year and total foreign investment had risen to 9% of Russia's GDP. But only a quarter of this was foreign direct investment; the rest came in the form of loans and portfolio investments. As Kirill Rogov of the Institute of Economy in Transition, a think-tank, explains, this reflected the strength of Russia's reserves and the weakness of its investment climate. Whereas other emerging economies were fighting tooth and nail for direct investment, Russia was borrowing cheaply instead, he says.



When the world economy started to wobble, the government increased its spending by 40% to boost consumption, says Evgeny Gavrilenkov, chief economist at Troika Dialog, an investment bank. With demand outpacing supply, the Russian economy started to overheat. Inflation topped 15% during the summer. Held back by red tape, the strong rouble and weak property rights, Russian industrial production grew by 5.4% in the first nine months of this year and imports in the same period shot up by 42%. Yekaterinburg is full of department stores, but hardly anything that is sold in them is produced around there. What is made locally is tanks, exports of which did go up last year.

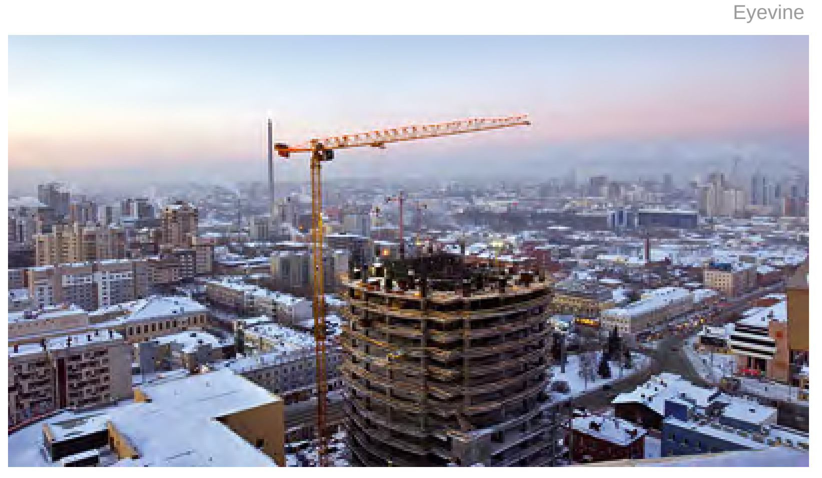
Even as the Russian stockmarket went into a nosedive, Mr Putin insisted that Russia had escaped the financial crisis. On September 13th, in an interview with France's *Le Figaro*, he gloated: "We did not have a crisis of liquidity; we did not have a mortgage crisis [like America or Europe]. We did not have it, we escaped it."

When the music stopped

But when the oil price started to fall, foreign banks stopped lending and money began to flow out of Russia, it became clear that the economy was more vulnerable and more highly leveraged than many investors had wanted to believe. The cranes in Yekaterinburg, and in many other Russian cities, are now standing idle. Production lines have ground to a halt and metal companies and carmakers have begun to sack workers.

The fall in the stockmarket mattered because Russian firms had borrowed heavily against their shares and faced margin calls from their foreign creditors. Mr Illarionov says this is a "standard" credit and liquidity crisis rather than a budget crisis. Compared with many other countries Russia still has plenty of cash, even if its reserves are dwindling at a worrying rate. Leaving aside the recent spending spree, the country's overall macroeconomic policy has been sensible. For the past eight years the government has been running budget and current-account surpluses. If growth were to slow down to 3% next year, as some analysts predict, that would still be more than in most countries.

Eyevine



All quiet now in Yekaterinburg

Igor Shuvalov, the first deputy prime minister, puts a brave face on it: “High oil prices corrupted us, inflated our expenditure and distorted our economy. If this crisis had not happened now, by 2011 the quality of credit portfolios would have been much worse. So it is a blessing. Now we can start the real project, to develop domestic industry and the financial sector.”

In essence Russia’s problems are political, not economic. “We have come to this crisis well prepared,” says Yegor Gaidar, a former prime minister and architect of Russia’s post-Soviet economy. “But now we need to stop nationalising companies and cut down on populism. You can make any argument for nationalisation, but when Russia started to nationalise its oil industry production stopped growing.”

Russia may also need to devalue the rouble. The central bank recently allowed it to depreciate slightly against a basket of currencies, but it still intervenes in the market to defend it. Politically a strong rouble has become a proxy for a resurging Russia and devaluing it or letting it float would hurt Mr Putin’s reputation.

As Mr Rogov explains, it would do no harm if Russia’s highly leveraged oligarchs were to hand over their stakes to foreign creditors, but the Kremlin would not allow this. The risk is that instead of clearing the system and promoting the most efficient firms, the crisis is helping the least efficient. The government is already introducing protectionist measures.

“The crisis itself is less grave than the potential consequences of the government’s actions in solving it,” says Andrei Sharonov, a former deputy economics minister who now works in the private sector. The government has earmarked a total of more than $200 billion for various rescue measures, which as a proportion of GDP is almost three times what the Americans are spending. But in contrast to America, there is little public scrutiny of what the money goes on. The first victims to be rescued by the government were two banks said to be closely linked to senior government officials.

To unblock the banking system, the government deposited $50 billion in three banks, two of which are state-linked. The third used to be controlled by Gazprom and is now owned mostly by private individuals. The idea was that the banks would inject liquidity into the system, but in the event they did not lend the money on to other banks, so now the government decides whom they should lend to.

Another $50 billion of the rescue money was earmarked for bailing out “strategic” companies. At the front of the queue were Russia’s largest oil and gas companies, including the state-controlled Gazprom and Rosneft. Igor Sechin, the powerful deputy prime minister in charge of energy, seems to have promised $9 billion of government money to energy companies. Half of it will go to Rosneft, which has a debt of $20 billion that goes back to its controversial takeover of the Yukos oil company. Mr Sechin is also the chairman of Rosneft and, says Mikhail Khodorkovsky, the former boss of Yukos (and now in jail), the man who destroyed his company.



Next came electricity companies, carmakers and anyone else who could think of a good reason to ask for help. As one Russian oligarch observed, a lot of people in the Kremlin would like to take back the companies that were privatised in the 1990s. Back then the oligarchs lent money to the cash-strapped state and got assets at knock-down prices in return. Now it is the companies that are in debt, whereas the state is cash-rich and can buy the assets back cheaply. To make them even cheaper, government officials publicly threaten companies or dig out old charges against them, as Mr Sechin has recently done with one of Russia’s largest fertiliser producers.

The crisis has also changed the behaviour of private firms. In the past the market pushed them to improve their governance, but now they are encouraged to look towards the state, says Roland Nash of Renaissance Capital.

Mr Shuvalov admits that some private assets might end up in state hands, but he insists that the government does not intend to keep them. The question is how, and to whom, these assets will be sold. Nationalising businesses is risky in any country, but in Russia, with its weak institutions and powerful Kremlin clans, it is almost certain to lead to a redistribution of property to the ruling elite, mainly past

and present members of the security services, collectively known as *siloviki*, or hard men.

Neither one thing nor the other

The new entities that could emerge from the crisis may be neither state nor private, says Mr Rogov, but the worst of both worlds: opaque, quasi-state firms run by people affiliated with the Kremlin. One model for this form of ownership is a privately controlled subsidiary of a state-controlled company. Another is something called a “state corporation”.

One example is Russian Technologies, run by Sergei Chemezov, a former KGB officer and a friend of Mr Putin’s from the 1980s when the two served together in East Germany. Until last year Mr Chemezov was in charge of a state arms-trading monopoly, which did not stop him from taking over a successful private titanium business and a car factory. This year his empire, now under the umbrella of Russian Technologies, has grown even further. State corporations’ assets, Mr Chemezov once said, “are neither state not private”; they are “state commerce”.

He has successfully lobbied for the inclusion in Russian Technologies of some 420 mostly state-controlled companies, some of which—such as airlines or property—seem to have little to do with the corporation’s declared aim of promoting technology. Alexei Kudrin, Russia’s finance minister, noted that giving Russian Technologies all these assets would amount to “a covert privatisation and the loss of control over how the proceeds are spent”. But his words fell on deaf ears.

Another state corporation is based on Vneshekonombank (VEB), which is meant to be bailing out Russian firms that need to refinance their foreign debt. The committee that decides on the bail-outs is chaired by Mr Putin himself. VEB has recently lent $4.5 billion, well above its supposed limit, to Rusal, a company controlled by Oleg Deripaska, a Russian aluminium tycoon, so he could repay a foreign loan backed by 25% of Norilsk Nickel, the world’s largest nickel producer. In return VEB will include government officials in the company’s management and board. But even before the crisis Norilsk Nickel’s controlling shareholder, Vladimir Potanin, one of the most politically savvy oligarchs, had put a former KGB officer in charge of the company—to be on the safe side.

The projection of KGB power in Russia’s politics and economy has been a guiding principle of Mr Putin’s period in office. In the past the *siloviki* often had to rely on tax inspectors or the Federal Security Service (FSB) to get hold of assets. Now the crisis is creating new opportunities for what Mr Illarionov calls the “KGB-isation of the economy”. The result, he explains, could be a new, highly monopolistic system, based on a peculiar state-private partnership in which the profits are privatised by Kremlin friends and debts are nationalised. This will not take Russia back to a state-run economy, but it is likely to shift it further towards a corporatist state.

Economist.com SPECIAL REPORTS

Grease my palm

Nov 27th 2008
From The Economist print edition

Bribery and corruption have become endemic

RUSSIA may not have democratic elections or the rule of law, but it does have one long-standing institution that works: corruption. This has penetrated the political, economic, judicial and social systems so thoroughly that is has ceased to be a deviation from the norm and become the norm itself. A corruption index compiled by Transparency International gives Russia 2.1 points out of ten, its worst performance for eight years and on a par with Kenya and Bangladesh. Ordinary Russians are well aware of this, with three-quarters of them describing the level of corruption in their country as “high” or “very high”.

The size of the corruption market is estimated to be close to $300 billion, equivalent to 20% of Russia’s GDP. INDEM, a think-tank that monitors and analyses corruption, says 80% of all Russian businesses pay bribes. In the past eight years the size of the average business bribe has gone up from $10,000 to $130,000, which is enough to buy a small flat in Moscow.

A businessman who was stopped by the traffic police in Moscow recently was shown a piece of paper with “30,000 roubles” written on it. He refused to pay and asked the policeman why he was being asked so much for a minor offence. “The answer was that the policeman had bought a flat for his mother in Bulgaria and he now needed money to do it up,” the businessmen said. Far from being a taboo subject, corruption is discussed openly by politicians, people and even the media—but it makes no difference.

Corruption has become so endemic that it is perceived as normal. Opinion polls show that the majority of Russians, particularly the young, do not consider bribery a crime. The Russian language distinguishes between “offering a reward” to a bureaucrat for making life easier for you, and the brazen (and sometimes violent) extraction of a bribe by a bureaucrat.

Small and medium-sized businesses suffer the most. Dmitry Golovin, who owns a tool-leasing company in Yekaterinburg, explains: “You go to the local administration to get permission for something and they send you to a private firm that will sort out the paperwork for you, which happens to be owned by their relatives.”

The reason for the persistent corruption is not that the Russian people are genetically programmed to pay bribes, but that the state still sees them as its vassals rather than its masters. The job of Russian law enforcers is to protect the interests of the state, personified by their particular boss, against the people. This psychology is particularly developed among former (and not so former) KGB members who have gained huge political and economic power in the country since Mr Putin came to office. Indeed, the top ranks in the Federal Security Service (FSB) describe themselves as the country’s new nobility—a class of people personally loyal to the monarch and entitled to an estate with people to serve them. As Russia’s former prosecutor-general, who is now the Kremlin’s representative in the north Caucasus, said in front of Mr Putin: “We are the people of the sovereign.” Thus they do not see a redistribution of property from private hands into their own as theft but as their right.


Novosti


What are we going to do about this?

The precedent was set by the destruction of the Yukos oil company in 2003-04. Mr Khodorkovsky, its then owner, was arrested at gunpoint in Siberia and after a sham trial sent to jail where he has spent the past five years. Yukos was broken into bits and, after an opaque auction, passed to Rosneft, a state oil company chaired by Igor Sechin, the ideologue of the *siloviki.*

Tricks of the trade

Mr Khodorkovsky was accused, among other things, of selling Yukos's oil through offshore trading companies to minimise taxation. So now Rosneft sells the bulk of its oil through a Dutch-registered trading firm, Gunvor, whose ownership structure looks like a Chinese puzzle. The rise in Gunvor's fortunes coincided with the fall of Yukos. A little-known company before 2003, Gunvor has grown into the world's third-largest oil trader, which ships a third of Russia's seaborne oil exports and has estimated revenues of $70 billion a year.

One of Gunvor's founders is Gennady Timchenko, who sponsored a judo club of which Mr Putin was honorary president and worked in an oil company that was given a large export quota as part of a controversial oil-for-food scheme set up by Mr Putin during his time in St Petersburg. Mr Timchenko says he was not involved in the deal and his success is not built on favours.

The Yukos case changed the logic of corruption. As INDEM's Mr Satarov explains, before 2003 officials simply took a cut of businesses' profits. After Yukos they started to take the businesses themselves. These days businessmen pay bribes as much to be left alone as to get something done. They call it a "bribe of survival".

This new form of corruption is changing the structure of the Russian economy. "Yeltsin-era corruption ended in a privatisation auction, even if it was a fake one. The new corruption ends in the nationalisation of business," says Yulia Latynina, a writer. Nationalisation is not quite the right word, however, because sometimes state property is quietly transferred into private bank accounts. And even where a business is formally controlled by the state, the profits or proceeds from share sales may never reach its coffers.

When Mr Medvedev was chairman of Gazprom, a state-controlled gas giant, one of his first jobs was to oversee the return of assets which had been siphoned off under the previous management. But as Boris Nemtsov and Vladimir Milov, two opposition politicians, explain in a recent book, "Putin and Gazprom", in the past few years Gazprom's control over its multi-billion-dollar insurance company and part of its pension funds has passed to a private bank called Rossiya, controlled by Yury Kovalchuk, who is thought to be a friend of Mr Putin's. The bank advertises itself as "Rossiya: the country of opportunities".

A necessary evil?

Both Mr Medvedev and Mr Putin condemn corruption in public. In a recent speech Mr Putin grumbled: "Anywhere you go, you have to go with a bribe: fire inspection, ecologists, gynaecologists—everywhere. What a horror!" Mr Medvedev's first presidential promise was to fight corruption for the Russian public, and recently he thundered: "We have to do something. Enough of waiting! Corruption has become a systemic problem and we have to give it a systemic answer." Soon afterwards he appointed himself head of a new anti-corruption committee.

Mr Satarov says this may be more than just populism. "They feel that the system has become unmanageable. They also need to protect and legalise the wealth they have accumulated in the previous five years—hence all this talk about building a legal system."

As a former lawyer, Mr Medvedev has started with legislation. A new draft law requires bureaucrats to declare their own and their family's income and assets. But there are a couple of loopholes. First, the information about their income is confidential and available only to other bureaucrats. Second, the family is defined as spouse and under-age children—but not siblings, parents or grown-up children. "It is as if the government is telling everyone which accounts they should transfer the money into," says Elena Panfilova, head of Transparency International Russia.

The trouble is that corruption in Russia has become a system of management rather than an ailment that can be treated, explains Ms Latynina. Central to this system is the notion of *kompromat*, or compromising material. "It is easier to control

someone if you have *kompromat* on them, so that is how a boss often chooses his subordinates," she says.

The only way to fight corruption, explains Ms Panfilova, is through political competition, independent courts, free media and a strong civil society. Those things may not get rid of it, but at least they would establish uncorrupt norms. Yet fighting corruption from within the Kremlin would require the skills of a Baron Münchhausen, who famously escaped from a swamp by pulling himself up by his own hair. As Mr Khodorkovsky said in a recent interview: "The fight against corruption is a fight for democracy." The interview cost Mr Khodorkovsky 12 days in solitary confinement. But the cost to Russia of allowing corruption to flourish is a lot higher.



A matter of judgment

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From The Economist print edition

Russia's legal system is deeply flawed

DESPITE Mr Putin's promise to establish a "dictatorship of the law", the judiciary in Russia is far from just. At least that is the view of Sergei Pashin, a former judge and now a law professor. He should know: in 2000 he was dismissed after supporting a young man who had political objections to serving in the army. Mr Pashin was later restored to office, but the young man he helped to free died in mysterious circumstances.

The trouble starts with the selection of judges, says Mr Pashin. The process looks reasonable on paper, but it leaves scope for interference. Judges are appointed either directly by the president or on his recommendation by the upper chamber of parliament. But most of them are first screened by a Kremlin commission which includes the deputy heads of the security services and the interior ministry. And although judges are appointed for life, their careers (and perks) are in the hands of the chairman of their particular court, who is appointed for a six-year term, renewable once. To get that second term he has to prove his loyalty, Mr Pashin explains.

The criteria for assessing a court's work are the number of cases it processes and the number of successful appeals against its decisions. To avoid too many appeals, a trial judge often seeks informal advice from a judge in a higher court. Astonishingly, fewer than 1% of criminal cases tried by a judge end in acquittals. But in jury trials, which were introduced in all Russian regions except Chechnya in 2002, the acquittal rate is about 20%.

However, prosecutors quickly found a way round the new system. For a start, most cases coming before a jury involve a confession, often obtained under duress. Yet when evidence of torture is presented, juries have to leave the room. Second, a jury can be dismissed if it includes someone linked to the police or security services, so prosecutors often plant such people in juries so that the verdict can be overturned if it is inconvenient.

Things are not much better in corporate disputes. Large companies rarely trust in a judge's unprompted decision. In commercial courts a judge often takes a bribe for reaching a speedy conclusion. All this helps to explain why the European Court of Human Rights is overwhelmed with Russian cases, and why large Russian companies seek justice in London. The Yukos case showed that the courts have become part of the Kremlin machinery. The problem, says one Moscow lawyer, is that "the law in Russia is often trumped by money and always by high-level power."

The incredible shrinking people

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From The Economist print edition

Russians are dying out, with dire consequences

YOU do not need to travel far to find evidence of Russia's demographic problems. Just 250km west of Moscow, in the Smolensk region, it is glaringly obvious. Turn off the main road in the village of Semlevo and you will see rusting gates and derelict buildings. Continue for a short distance on what just about resembles a road and you will see a new cowshed.

A third of the people working here are from Tajikistan. Marina, a 38-year old Russian milkmaid, is married to one of them. Talib, she says, may be strict, but he does not drink or beat her up. She prefers him to her first, Russian, husband who drank himself to death at the age of 47, leaving her with three children. Her 19-year old son is unemployed and drinks heavily.

Talib came to Russia so that he can feed his other family in Tajikistan, and Marina does not mind Talib having another wife. But local residents resent the Tajik and Uzbek migrants because "they are prepared to work for a pittance and take our jobs." Yet finding sober local working men in the village is difficult, says Sergei Pertsev, the farm manager. "Here, everyone has fallen ill with alcohol." To make sure the farm functions properly Mr Pertsev keeps people in reserve, to fill in for those who go on a binge. It used to be mainly men who drank, but now women do too.

Semlevo's collective farm was built in 1962. Since then the village's population has dropped to a third of its former level. Thirty years ago the village school had 500 pupils. This year only one girl entered the first grade. Some people have left the village, others have died of drink. Those who remain drink heavily. Still, by local standards, Semlevo, with its 900 residents, is a thriving metropolis. Some nearby villages have just two or three people left.

Novosti



Rare and precious

Tatyana Nefedova, a geographer and specialist on Russian agriculture, calls these deserted areas "Russia's black hole". In the European part of the country alone they account for one-third of the land mass. Urbanisation has drawn people from villages into larger cities and to the vast industrial building sites in the east and north of the country. Active life is concentrated in a radius of 35-40km from the centre of these large cities. Russia has only 168 cities with a population over 100,000 and their number is dropping. The average distance between large cities is 185km. According to Ms Nefedova, this means that a stretch of 100km between them is a social and economic desert. In villages closer to large cities, especially Moscow and St Petersburg, or in the south of the country, things are better.

But for Mr Pertsev, the idea that Russia is "rising from its knees" seems like a bad joke. Two years ago he lost his son, who was in the army. The young man was killed by a drunk driver who crashed into a column of soldiers in the dark. "The only people who live well in this country are those who make

decisions, sit on an [oil] pipe or those who guard it," says Mr Pertsev.

The sorry state of villages like Semlevo is the result of "negative social selection", says Ms Nefedova: the most active and able people have migrated to large towns. Few people have stayed behind, and most of those are unable to work. In Semlevo there is only one farmer who keeps his own sheep and chickens. Most houses there have no running water, plumbing or gas heating. Still, Semlevo's old collective farm is considered lucky: it was recently bought by a businesswoman from Moscow. Most other collective farms in this district are dead.

Russia's demography befits a country at war. The population of 142m is shrinking by 700,000 people a year. By 2050 it could be down to 100m. The death rate is double the average for developed countries. The life expectancy of Russian males, at just 60 years, is one of the lowest in the world. Only half of Russian boys now aged 16 can expect to live to 60, much the same as at the end of the 19th century.

No babies to kiss

"If this trend continues, the survival of the nation will be under threat," Mr Putin said in his first state-of-the-nation address in 2000. Six years later he offered an increase in child support and a bonus for second babies. Since then the birth rate has started to climb, the number of deaths has declined and life expectancy has edged up a little (see chart 5). Mr Putin rejoiced: "We have overcome the trend of rising deaths and falling births...In the next three to four years we can stabilise the population figures."

But demographers say there are few grounds for optimism, and Russia's goal of increasing the population to 145m is unattainable. Anatoly Vishnevsky, Russia's leading demographer, says an increase in the number of births in a single year does not reverse a trend. People may respond to financial incentives by changing their timing rather than having more babies overall. An extra $100 a month is helpful to people with low incomes and rural or Muslim families, who have more children anyway, but is unlikely to persuade middle-class families to produce more babies.

Drooping 5

Population, m

Life expectancy and birth rate

Births per 1,000 population

Life expectancy at birth, years

Source: United Nations

The main reason for the recent rise is that there was an uptick in the birth rate in the 1980s and the people born during that period are now having children themselves. But the next generation to reach child-bearing age is much smaller. "What we are going to see over the next few years is a rapid decline in the number of births," says Mr Vishnevsky. At the same time the death rate is likely to go up, not because people will die any earlier but because the generation which is getting to the end of its life now is larger than the one born during the war.

Russia's demographic crisis is one of the main constraints on the country's economy. Although Russia's population has been ageing, over the past decade the country has enjoyed a "demographic dividend" because the age structure was in its favour. This dividend has now been exhausted and the population of working age will decline by about 1m a year, increasing the social burden on those that remain. Over the next seven years Russia's labour force will shrink by 8m, and by 2025 it may be 18m-19m down on the present figure of 90m.

What makes a shrinking population dangerous for a country that has always defined itself by its external borders is the loss of energy it entails, Mr Vishnevsky argues. The Soviet Union did not just try to exploit the resources of its vast and inhospitable land, it tried to populate it. Now large swathes of land in Siberia and the far east are emptying out as people move to central Russia. The population density in the country's far east is 1.1 people per square kilometre. On the other side of the border with China it is nearly 140 times that figure.

The decline in Russia's population is often linked to the collapse of the Soviet Union. In fact, the pattern was set back in the mid-1960s when the number of births fell below replacement level and life

expectancy started to shrink. In 1964, after several years of post-Stalin thaw, life expectancy for men was 65.1 years, only slightly lower than in the West. But by 1980 the gap with the West had widened to more than eight years and is now 15 years.

Russia's health problems, says Mr Vishnevsky, were partly a legacy of the cold war. By the middle of the 20th century the developed world had learnt to control infections that killed large numbers of people. The next targets were illnesses caused by lifestyle, such as heart attacks, pollution and respiratory diseases. But whereas the West invested heavily in health-care systems and better lifestyles, Russia was putting its financial and human capital into the arms race and industrialisation.

If life expectancy in Russia had improved at the same pace as in the West, the country would have had an extra 14.2m people between 1966 and 2000, adding 10% to the population. The Soviet Union's spending on health care was less than a quarter of the American figure. The Communist Party elite was well looked after, but ordinary people were less fortunate.

Crucially, the paternalistic Soviet system, which survives in today's Russia, was geared towards fighting epidemics and infections rather than to empowering people to look after their own health. Even now Russian doctors treat patients and their relatives like imbeciles. Officially the state guarantees free care for all, but half the patients offer gifts and money to doctors and the other half often have to forgo necessary treatment.

Boosting the country's health-care spending was one of the "national projects" Mr Medvedev was in charge of before becoming president. Last year its funding doubled to 143 billion roubles ($5.8 billion). That is still below Western standards, but the main problem is that it is not well spent. For example, the government more than doubled general practitioners' pay. But as Sergei Shishkin of the Independent Institute for Social Policy argues, the pay increase was not linked to performance and created a sense of injustice among specialists.

The curse of the bottle

Russian history, particularly in the 20th century, has encouraged the view that life is cheap. But there is also a strong self-destructive streak in the national character. Drinking yourself to death is one of the most widely used methods of suicide.

Alexander Nemtsov, a senior researcher at the Institute of Psychiatry, points to a clear correlation between the death rate and the consumption of alcohol in Russia. A short anti-alcohol campaign conducted by Mikhail Gorbachev in the late 1980s extended life expectancy by three years. Mr Nemtsov estimates that nearly 30% of all male deaths and 17% of female deaths are directly or indirectly caused by excess alcohol consumption and that over 400,000 people a year die needlessly from drink-related causes, ranging from heart disease to accidents, suicides and murders.

The average Russian gets through 15.2 litres of pure alcohol a year, twice as much as is thought to be compatible with good health. The problem lies not just with how much but also with what is drunk: moonshine and "dual-purpose" liquids, such as perfume and windscreen wash, make up a significant proportion of alcohol consumption, according to Russia's chief physician, Gennady Onishchenko. Tens of thousands a year die of alcohol poisoning, against a few hundred in America. In large cities the fear of losing a job, and growing car ownership, is keeping people soberer.

The most obvious reason why Russians drink so much is the low price and easy availability of alcohol. Consumption increased dramatically in the 1960s when the state hugely boosted production. People started drinking not just on special occasions but during the week and at work too.

Vodka is one of a very few Russian products that seem relatively immune to inflation. Between 1990 and 2005, for example, the food-price index increased almost four times faster than the alcohol-price index. A cheap bottle of vodka in Russia costs the same as two cans of beer or two litres of milk. The easiest way to curb consumption would be to make hard spirits much more expensive and less accessible, as many Nordic countries have done. But as with many other things in Russia, corruption gets in the way: two-thirds of hard liquor is produced illegally and sold untaxed.

Occasionally the government raises the alarm about alcohol poisoning, but it does little to curb drinking. Instead it has declared war on Georgian wine and mineral water, which it claims is not fit for consumption. But life expectancy in Georgia remains 12 years higher than in Russia.

Unlike drinking, AIDS is a relatively new problem for Russia. The first case of HIV was recorded in 1987, but it took a long time for the country to take notice. By 1997 the number of cases had grown to 7,000. Now the official figure is over 430,000, the largest in Europe. The real number could be double that, according to the World Health Organisation. Most victims are under the age of 30. Some two-thirds are drug-takers, but the epidemic is now spreading to the general public.

The government seems to have woken up to the danger and has increased spending. But Vadim Pokrovsky, head of the federal AIDS centre, says Russia still lacks adequate prevention measures.

About 28,000 people have already died of AIDS-related illnesses, but the real number could be masked by a co-infection of HIV and tuberculosis which kills people after two or three months. The incidence of TB is the highest in Europe. Last year 24,000 people died of the disease, almost 40 times as many as in America, not least because most TB hospitals are crumbling and some lack sewerage or running water.

The only solution to Russia's demographic problems appears to be immigration, as in the village of Semlevo, but the Russian public is hostile to it.

Wanted but not welcomed

Most low-skilled migrant workers in Russia come from Central Asia. In the east of the country they are mainly Chinese. The precise figures are impossible to pin down because the vast majority of immigrants over the past decade have been illegal. Until recently they were treated much like serfs. They could not apply for work permits but had to rely on their employers, who would often impound their passports and refuse to pay them for their work. Thousands of corrupt police officers grew fat on the proceeds.

In the past couple of years the rules have become more accommodating and migrant workers can now apply for their own work permits and sign contracts with their employers. But for tax reasons only a quarter of immigrants do so. The new law has increased the number of legal migrants to more than 2m, but the real figure is thought to be five times that.

Eyevine



A cheap way to oblivion

Many migrants are scared to venture outside on their own for fear of running into police or skinheads. Employers much prefer illegal immigrants to local workers because they are cheaper and will put up with worse conditions. But a xenophobic public habitually vents its anger on the immigrants, even though they are estimated to generate 8% of Russia's GDP.

Support for extremist organisations such as the Movement Against Illegal Immigration has risen sharply in the past few years. More than half the population supports the slogan "Russia for the Russians" and almost 40% feel "irritation, discomfort or fear" towards migrants from Central Asia and Azerbaijan. Hate crimes are on the rise. SOVA, a body that monitors racism, last year counted 667 racist attacks, including 86 racially motivated murders.

At a recent pep talk with the editors of Russia's leading media, Mr Putin urged them to guard against xenophobia. Russia's new day of unity is traditionally marked by ultra-nationalist marches, and the youth wing of Mr Putin's own United Russia party campaigns against immigrants. Dmitry Rogozin, a nationalist politician who built his campaign for parliament in 2003 on anti-immigrant rhetoric, is now Russia's ambassador to NATO. On his office wall hangs a portrait of Stalin.

Economist.com SPECIAL REPORTS

The wild south

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Russia's treatment of its republics in the Caucasus has turned them into tinderboxes

"I DESIRE that the terror of my name should guard our frontiers more potently than chains or fortresses, that my word should be for the natives a law more inevitable than death," wrote Alexei Yermolov, Russia's legendary general who waged total war during his conquest of the north Caucasus in the early 19th century. A hero of the Napoleonic wars revered by Russian romantics, Yermolov is still universally hated by "the natives" who think of him as brutal, contemptuous and genocidal. In the late Soviet period his statue in Chechnya was regularly blown up until it was eventually thrown into the river.

On October 4th a new, giant statue of Yermolov on a red granite pedestal was unveiled in the ethnically Russian region of Stavropol that faces the north Caucasus, marking an unseen line of separation between Russia and the five Muslim republics on its southern border.

When the Soviet Union collapsed, Chechnya, the most rebellious of the five, demanded complete independence from Russia. Boris Yeltsin waged brutal war with it in 1994-96, with disastrous results. Vladimir Putin, trying to bring Chechnya to heel once and for all, resumed hostilities in an even more brutal form in 1999, with knock-on effects in the entire region. Nine years later the Caucasus still feels like a tinderbox. The Georgian war and Russia's unilateral recognition of South Ossetia and Abkhazia have added even more combustible material.

But the main cause of instability is Russia's colonial methods in the Caucasus, which have altered little since Yermolov's time. The difference is that he was conquering new territory, whereas Russia is dealing with people who are, at least on paper, its own citizens.

A peace of sorts

Chechnya is now relatively quiet under the thumb of a former rebel, Ramzan Kadyrov, who was installed as president by Mr Putin last year. Grozny, its capital, which was razed to the ground by the Russians, has been rebuilt. On October 5th Mr Kadyrov reopened the city's main thoroughfare, now lined with trees. It used to be called Victory Prospect, but Mr Kadyrov has renamed it Putin Avenue.

In recent local elections Mr Kadyrov, who is fiercely loyal to Mr Putin, promised that the turnout of voters for his hero's United Russia party would be "100% or even more". But it is not clear that his loyalty extends to Russia as a whole. As he himself has said: "I am not anyone's president, I am not a man of the FSB or GRU [Russian security services]. I am Putin's man…Putin is God's gift, he gave us freedom."

And Chechnya is indeed much freer of Russian control than it was eight years ago. Mr Kadyrov has his own armed forces, makes women wear headscarves, levies his own tax on businesses and sets his own rules. The day after the unveiling of the new-look Putin Avenue the occupants of the ground-floor offices, cafés and shops found their premises sealed off. Before they could start trading again they had to pay a "fee" of 200,000-500,000 roubles to some agency.

Recently Mr Kadyrov asked for Grozny airport, which is federal property, to be made over to Chechnya and given international status. It would also be nice for Chechnya to have its own customs service, he said. As for the Russian troops still stationed in his republic, he thinks their main job should be to guard Russia's international borders, not to meddle in Chechnya's affairs.

Yulia Latynina, a Russian journalist and writer, says that "the war between Russia and Chechnya was won by Mr Kadyrov." But although military resistance in Chechnya itself has subsided, violence has spread to neighbouring republics, notably Ingushetia and Dagestan. It is transmitted by state-sponsored repression, corruption and lawlessness that alienates and radicalises the population and drives young men into the hands of Islamist militants.

Ingushetia, a Muslim republic with a population of just 500,000, has turned into the region's new flashpoint. Reports of killings, explosions and kidnappings have been coming in daily. In the past year the number of attacks on police by Islamist militants, both Chechen and Ingush, has almost doubled. In return, the Russian security and military services have terrorised the local population, using much the same methods as the militants.

Sliding into anarchy

On a recent visit, cars with tinted windows and no licence plates raced around Nazran, Ingushetia's grim capital. Traffic policemen left their posts as soon as the sun set, in fear for their lives. "We don't know who is fighting with whom, but every day mothers cry over their children," said Zarema, who was selling Chinese clothes in a market. "If I am a Russian citizen, why are they not protecting me?" The word most often heard in Nazran is *bespredel*, or anarchy.

Almost everyone curses Murat Zyazikov, an ineffectual former KGB general installed by Vladimir Putin as the republic's president in 2002. Under his watch 600 people died and 150 disappeared without a trace, says Bamatgiri Mankiev, a former member of parliament and now one of the opposition leaders. Yet Mr Zyazikov could not be voted out because in 2004 Mr Putin abolished regional elections across Russia. Only when the situation came to resemble a civil war did the Russian government remove Mr Zyazikov on October 30th and appoint a tough military commando instead. As the Ingush celebrated Mr Zyazikov's departure, his officials were clearing anything of value from the administrative buildings.

At a recent protest rally demonstrators threatened to call a referendum on independence for Ingushetia unless the government in Moscow treated them as Russian citizens. The cause of the rally (and probably of Mr Zyazikov's removal) was the brazen murder of Magomed Yevloyev, the editor of an opposition website that publicised human-rights abuses. He had irritated Mr Zyazikov by running an "I did not vote" campaign, collecting 90,000 signatures to counter the official claim that 98% of Ingushetia's 164,000 voters cast their ballot for the Kremlin's party in last year's parliamentary election.

Reuters



Kadyrov is Putin's man

On August 31st Mr Yevloyev arrived in Nazran on the same flight as Mr Zyazikov. When they landed, Mr Zyazikov was whisked off in a limousine and Mr Yevloyev was arrested and driven away in an armoured car. Minutes later he was dead, "accidentally" shot in the temple by one of the guards in the car. His body was dumped in front of a hospital. When Mr Yunus-Bek Yevkurov took over from Mr Zyazikov, he immediately offered his condolences to Mr Yevloyev's family.

Over the past 60 years Ingushetia has seen little kindness from Russia. In 1944 Stalin deported the entire Ingush and Chechen populations in cattle trains to Kazakhstan. When the survivors returned in 1957 they found their houses occupied by the mainly Christian North Ossetians. In 1991 Boris Yeltsin signed a law restoring the territorial rights of the Ingush. But the mechanism for this "territorial rehabilitation" was never established and soon a bitter conflict broke out between the Ingush and the North Ossetians.

Russia took the Ossetians' side, allowing them to push 60,000 Ingush out of the Prigorodny district. Some 18,000 refugees are still unable to return home. The official explanation is that "their neighbours are not prepared to live next to them."

Russia's war in Georgia and its backing of the South Ossetians inflamed feelings of injustice and anger in Ingushetia. Many Ingush identify with Georgia more than with Russia. And Russia's recognition of South Ossetia and Abkhazia has created new precedents for the North Caucasus.

Ruslan Aushev, Ingushetia's first post-Soviet president, feels strongly about the issue: "Russia fought two wars in Chechnya, which cost a lot of lives, blood, sweat and money, defending the principle of its own territorial integrity. Now it has recognised two small republics and added two new hotspots to its existing problems. This does not bode well for Russia." The biggest mistake the Kremlin made in the

Caucasus, he says, was to use force.

The irony is that despite the many historic injustices it suffered, Ingushetia has traditionally been loyal to Moscow. The problems in Ingushetia, says Ekaterina Sokiryanskaya of Memorial, a human-rights group, are of Russia's own making. Most of them stem from indiscriminate violence in the second Chechen war which spilt over into Ingushetia.

Until 2001 Mr Aushev, a charismatic military commander who had served in Afghanistan, managed to keep Ingushetia relatively stable. He resisted attempts by the government in Moscow to drag the republic into the Chechen war and did not allow it to be used as a military base for the Russian army. Keeping Ingushetia neutral was no mean achievement, given its close ethnic ties with Chechnya. When Russian forces carpet-bombed the Chechen capital, Mr Aushev ignored Russian orders to cut off all escape routes from Chechnya and allowed 300,000 Chechen refugees into Ingushetia.

But in 2002 Mr Aushev was replaced by the much more co-operative Mr Zyazikov. The first bout of violence in Ingushetia was directed at Chechen refugees. Alleged rebels and their sympathisers were kidnapped and often tortured, both by Mr Kadyrov's forces and by their Russian backers. An Ingush official who tried to investigate the Russian security services' behaviour was himself kidnapped by the FSB. Mr Zyazikov did nothing.

Tit for tat

The violence soon engulfed the republic and in 2004 Nazran was attacked by armed rebels. "At the time", says Ms Sokiryanskaya, who spent five years in Ingushetia, "everyone was shocked by how many Ingush took part in the attack. Today no one is surprised that Ingushetia has its own armed underground." According to a survey carried out by Ms Sokiryanskaya with a North Ossetian think-tank, the main reason young people join the armed rebels are personal revenge, the violence of the security services, unemployment and propaganda by religious extremists.

Timur Akiev, who heads the Nazran office of Memorial, says the tactics of the Russian security services changed after 2005. Until then suspects were taken to North Ossetia, where they were tortured and made to confess. They were then brought back to Ingushetia for trial and sent to jail. However, jury trials in Ingushetia stopped relying on such "confessions" and started to acquit suspects. Mr Akiev says that from then on people started to disappear or were shot during arrest even if they showed no resistance. Sometimes the dead bodies were fitted up with weapons or grenades.



What eventually sparked public protests in Ingushetia was the killing of a six-year-old boy. Early in the morning of November 9th 2007 three armoured personnel carriers, several minivans and a military truck, all without number plates, drove into a small Ingush village as part of a "special operation" to capture an alleged terrorist. After throwing a smoke bomb through the window of a house, a group of armed men burst in and opened fire. But all they found was a family of five. One of the bullets had killed the youngest child.

When the soldiers realised what they had done, they made it look as though they had been attacked, throwing grenades at the empty house, moving the child's body and putting a machine gun next to it. The Ingush authorities took three days to react to the murder. Mr Zyazikov promised personally to

supervise the investigation. So far no one has been arrested.

When people took to the streets, they were dispersed by the police in brutal fashion. A group of TV journalists who had arrived from Moscow to cover the murder and the protest were kidnapped from their hotel, beaten and “deported” from Ingushetia as if it were a separate state.

Two months later people came out in protest again, carrying pro-Putin banners and pleading with him to protect them from state lawlessness. Mr Putin dismissed the protests with the words: “Someone had decided that Ingushetia is a weak link in the Caucasus and we see attempts to destabilise the situation there.” Maksharip Aushev, an opposition leader in Ingushetia (no relation to the former president), spoke for many when he said: “Until then I could have bet that Putin did not know what was going on here, that the money is stolen, that unemployment is almost 80%, that people get abducted. But it is now clear that we have to do something ourselves.”

Until last year Mr Aushev ran a successful marble-trading business and had little interest in politics. But in September last year his son and his nephew were abducted by the security services. He launched his own search and forced the local prosecutors to investigate what turned out to be a secret prison in Chechnya where Ingush residents were being taken for torture and execution. Mr Aushev later learnt that his son and nephew were taken to the mountains to be executed with snickers (explosives tied to their bodies) but at the last minute they were let go.

Unable to convey their anger through the ballot box and unwilling to take up arms, Mr Aushev and several others have set up an alternative parliament elected by family clans. They have agreed to co-operate with Yunus-Bek Yevkurov, Mr Zyazikov’s replacement, who had previously commanded Russian troops in Kosovo and taken part in special operations in Chechnya. His first steps were encouraging, but to stop the violence he will have to fight both the militants and the federal forces who have got out of control. Unless Russia stops treating this region as enemy territory and begins to observe its own laws here, violence will escalate.

More devolution please

What happens in the Caucasus will define the future of federalism and of territorial integrity in the whole of Russia. The central government’s policy failures in the Caucasus are particularly clear when compared with the far more successful policy being pursued in Tatarstan, the largest Muslim republic, which was integrated into the Russian empire in the 16th century and has been at peace ever since. In the early 1990s oil-rich Tatarstan became a symbol of decentralisation in Russia. It was here that Yeltsin famously said: “Take as much sovereignty as you can swallow.” Under Mr Putin this phrase came to symbolise the weakness of Mr Yeltsin’s regime. In fact it was its strength. It is the centralisation of power and the colonial methods of suppression of dissent that are the biggest threat to that territorial integrity.

Handle with care

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A cornered Russia could pose greater risks

THE magic word during Vladimir Putin's eight years as president was "stability". The social contract between the Kremlin and the people was based on rising incomes and private freedoms. Most people happily signed up to this. According to Boris Dubin, a leading sociologist, three-quarters of the Russian people feel they have no influence on political and economic life in their country, and the vast majority of them show little interest in politics anyway.

It was this contract, backed by high oil prices and cheap credits, that kept Mr Putin's ratings up and allowed him to hold on to power as prime minister after his protégé, Dmitry Medvedev, was installed as president in March this year. When a foreign journalist asked Mr Putin shortly before the election why Mr Medvedev was not campaigning, the answer was candid: "Salaries in Russia are growing by 16% a year… people want this trend to continue and they see Dmitry Medvedev as a guarantor of this trend."

The rise in earnings, albeit from a low base, has also masked discontent about the appalling state of the health system and the corrupt and ineffective police. Most people say both have been getting worse in recent years, but they generally deal with them by making private arrangements with their local doctor and finding friends among the police. Seventy years of living in the Soviet Union have made them inventive and adaptable.

The lives of ordinary Russians have got better, but not that much better. Half of them say they have enough money for food and clothes but struggle to buy durable goods. Most simply hoped things would not get worse. Now, with an economic downturn under way, things are getting worse, especially in big cities where the improvements had been most noticeable. Private firms are starting to lay off staff and cut pay. For now the government is trying to soothe people's fears. Journalists have been told not to link the words "crisis" and "Russia", so the state media consistently talk only about a world crisis and Russia's "anti-crisis" measures.

Yet if the economy deteriorates, that will no longer be enough. A recent survey of successful young urban people showed that many of them contemplate emigrating. For now, most people have even less appetite for protests than they did in 1998, when rouble devaluation and debt default caused millions to lose their savings.

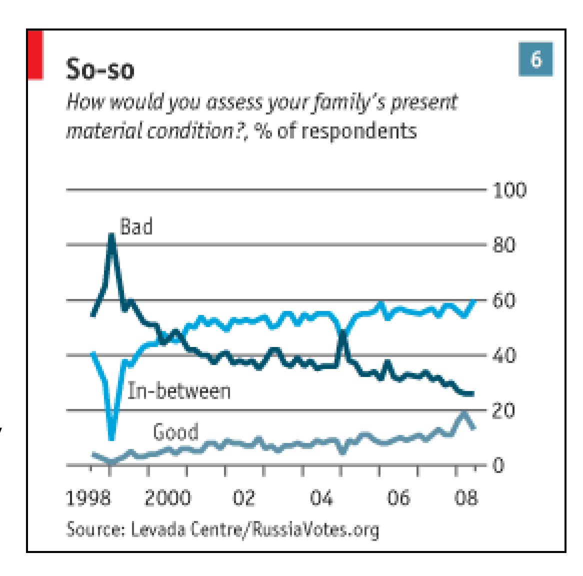
Most Russians are deeply cynical about their government: 60% say its members are "only concerned with their own wealth and careers" and just 9% say they are honest. After the 1998 crisis businessmen who had lost everything picked themselves off the floor and started again, and the same thing may happen this time, although state interference in business has increased. But the popularity of Mr Putin and Mr Medvedev, who are seen as promoting stability, is likely to suffer. After the 1998 crisis Yeltsin's approval ratings, already in the dumps, plummeted from 15% to 1%.

Yet there are important differences between then and now. First, people have more to lose. Over the past decade GDP per person has almost doubled, to almost $12,000 at purchasing-power parity. Second, Russia's rigid political system no longer allows much room for manoeuvre. When the 1998 crisis struck, Mr Yeltsin defused the situation by sacking the prime minister and the entire government. Until last year Mr Putin too had this option. When things went wrong people blamed the government, not the president. But now that Mr Putin himself is in the prime ministerial seat it may be harder for him to find scapegoats.

Third, in 1998 the government was bankrupt and weak, so businesses were left to deal with the crisis in their own way. Now the government is sitting on massive cash reserves which have already become the object of factional fighting. The Kremlin is by no means a homogenous entity. Indeed, the main reason for making Mr Medvedev president under Mr Putin's supervision was that it would preserve the status quo. But now there may not be enough money to keep the large band of

Kremlin friends happy.

Russian experts, whatever their differences, all agree on one thing: these are unstable, unpredictable and dangerous times. As Mr Satarov of the INDEM think-tank observes, the biggest advantage of democracy is that it allows political systems to adapt to changing economic and political circumstances. That luxury is not available to Russia. Instead, Mr Medvedev has proposed extending the presidential term from four to six years. This was Mr Putin's idea, and he may be the one to benefit from it. The change, which has been rushed through parliament, would give him the prospect of 12 years as president when Mr Medvedev's term expires in 2012. Some say Mr Putin might return earlier.



Whatever next?

The most optimistic (but unfortunately least likely) scenario is that the crisis will concentrate minds in the Kremlin and make it improve the country's investment climate, build proper institutions and tame anti-American rhetoric. Mr Gavrilenkov of Troika Dialog argues that Russia's attitude to America is closely correlated with its balance of payments. When that is strong, Russia turns anti-American; when it is weak, Russia becomes a friendlier place.

There are some signs that the crisis has strengthened the hand of economic experts in the Kremlin, such as the finance minister, Alexei Kudrin. One of Mr Kudrin's deputies, Sergei Storchak, who was arrested a year ago in a power struggle between different factions, has suddenly been allowed out of prison. But as long as the oil price remains relatively high and economic growth in the rest of the world is weak, businesses will rely more on the government than on foreign investors.

Still, a recent survey of various Russian elites, including business and media people, lawyers and doctors, showed that some 45% disagree with the current authoritarian system. Worryingly, the same survey found that the group which feels most alienated and unhappy about the status quo is the armed forces.

The chances that Russia will indeed turn more liberal are minimal. The mood is against it, and liberal parties cannot even muster the support of the significant liberal minority that does exist. The Kremlin has launched its own "democratic" clone parties to gather up these votes. According to one modern Russian writer, Zakhar Prilepin, ideological opposition to the Kremlin is impossible because the elite has no ideology: it is capable of agreeing with both the extreme right and the extreme left of the political spectrum. Its only ideology is to stay in power.

ITAR-TASS

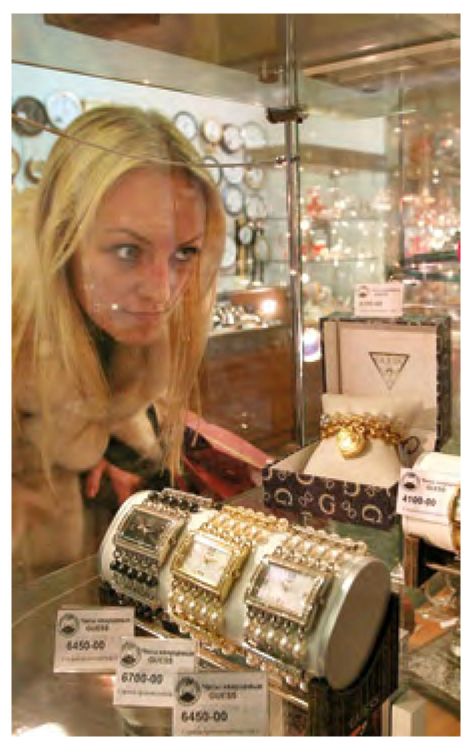
A more likely—and alarming—scenario is that the current regime will harden its stance and tighten the screws or be replaced by an even more nationalistic and militant one. That is the direction in which Russia has been moving for the past eight years. In his book, "The Death of the Empire", Mr Gaidar, the former prime minister, points to the dangers of post-imperial nostalgia in Russia and draws parallels with the dying days of Germany's Weimar Republic. The war in Georgia made those parallels more obvious. It has moved nationalist ideologues from the margins of political discourse to the centre.

According to Andrei Zorin, a cultural historian and professor of Russian at Oxford University, periods of restoration that follow revolutions do not bring back the old order but often introduce new threats and instability. "Russia may yet emerge as a nation state, but in the process it could also turn ugly and nationalistic," he says. In such a multi-ethnic country that would be a recipe for further disintegration.

Many Russian liberals argue that Western policy towards Russia has helped to make the country more nationalistic. America's triumphalism after the cold war caused the same sort of resentment in Russia as the settlement of the first world war did in Germany. America's unilateral withdrawal from the Anti-Ballistic Missile Treaty in 2001, its plan to

put a missile-defence system close to the Russian border and NATO's expansion played into the hands of Russian hardliners, as did the West's recognition of Kosovo. "You can only imagine how much champagne was drunk in Russia's hardline circles after the recognition of Kosovo," says Mr Gaidar.

Yet America acted as a catalyst, not the primary cause. The process that led to the war in Georgia had its own domestic logic inseparable from Mr Putin's authoritarian system. That system, says Lilia Shevtsova of the Carnegie Moscow Centre, relies on images of Russia as a "besieged fortress".



Some things have got better

More dangerous than the cold war

The Russian leadership can, and does, blame the current financial crisis on America. It is doing its best to mobilise Russians against the West and the Westernisers and is becoming more confrontational. That might conceivably lead to another war in the Caucasus or to an attack on Ukraine, vulnerable because of the ethnically Russian Crimea. Georgia remains a particularly explosive place. Russia's recognition of South Ossetia and Abkhazia has made things worse. Pavel Felgenhauer, a Russian military analyst who accurately predicted the Georgian war in August, says a new and possibly bigger military conflict is only too likely.

Since Russia's nationalism defines itself in relation to America and the West, much will depend on American diplomacy. Mr Gaidar argues that offering NATO membership to Ukraine or Georgia would be a gift to Russian nationalists. "This is not a return to the cold war. It is much more dangerous. With the Soviet Union everything was more or less clear and predictable. Both sides got used to each other and found a way of talking to each other. Both sides won in the second world war and were confident and not hysterical. Now we are dealing with a country that has suffered a collapse of empire. And a significant part of the Russian elite feels the time has come to fight back."

The biggest challenge for the West will be to find a policy that neither appeases Russia nor ignores it. Given the country's nuclear potential, its nationalism and its high levels of corruption, the risks are high. In the past Russia kept its nuclear technology out of reach of America's sworn enemies, but a power shift inside the country could change that.

Historically, Russia has often demonstrated an ability to take unexpected turns, whether for good or ill. Few people foresaw the collapse of the Soviet empire. Russia today has a glass-like quality to it: rigid and fragile at the same time, and liable to develop cracks in unforeseen places. The danger lies in its unpredictability. Yet that may also be a reason for hope.

Sources and acknowledgments

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Offer to readers

Nov 27th 2008
From The Economist print edition

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Online advertising

Not ye olde banners

Nov 27th 2008 | SAN FRANCISCO
From The Economist print edition

Internet advertising will be relatively unscathed in the downturn

Illustration by David Simonds



AT THE beginning of the year Jeff Zucker, the boss of NBC Universal, a big television and film company, told an audience of TV executives that their biggest challenge was to ensure "that we do not end up trading analogue dollars for digital pennies". He meant that audiences were moving online faster than advertisers, thus leaving media companies short-changed. Now, near the end of the year, the situation looks even worse, as the recession threatens to turn even the analogue dollars into pennies. Will this hasten the shift towards internet advertising, or will it decline too?

Advertising rises and falls with the economy, though how much is a matter of debate. Randall Rothenberg, the boss of the Interactive Advertising Bureau, a trade association for digital advertisers, points to the remarkable stability of advertising at about 2% of GDP since 1919, when the data began to be collected. This would suggest that ad budgets will move roughly in line with economic output.

But Mary Meeker, an internet analyst at Morgan Stanley, believes that modern ad budgets rise and fall much more than GDP does. According to her estimates, if the economy stops growing, ad spending is likely to fall by 4%. If the economy shrinks by 2%, overall ad spending may fall by 10%. As for the online segment, recent history is cause for pessimism. Between 2000 and 2002, during the dotcom recession, online ad spending in America fell by 27%.

Yet the web has changed a lot since 2002. Back then, gaudy display "banners" on web portals such as Yahoo! and MSN were the preferred technology. These still exist, but they now account for less than 20% of online ad spending. More than half goes to search advertising on Google and rival search-engines, which place small text ads next to results based on the keyword of the query, and charge only when a user clicks on them. In brand advertising, "rich media" ads are taking over from banners. These allow users to interact by clicking, so their engagement can be tracked.

All this makes spending on advertising much less speculative, so that it starts to be treated instead as a cost of sales. This is one reason why online advertising should suffer less than other sorts. This week eMarketer, a market-research firm, predicted that online-advertising spending in America, which makes up about half the global total, will increase by 8.9% in 2009, rather than the 14.5% it had forecast in August. The firm thinks search advertising will grow by 14.9% and rich-media ads by 7.5%, whereas display ads will grow by 6.6%. In short, online advertising will continue to expand in the recession—just

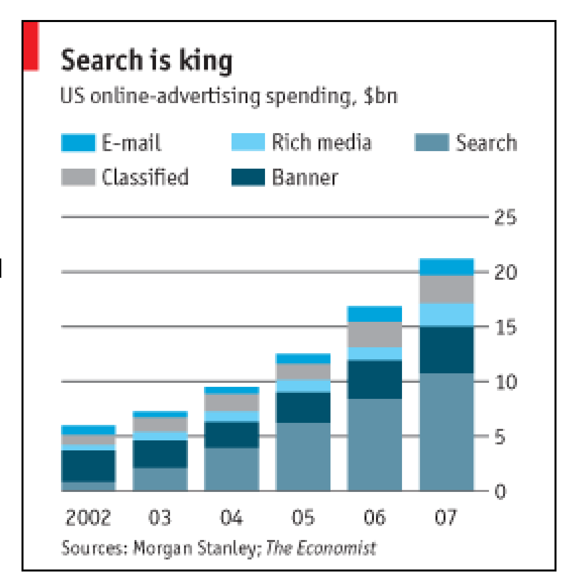
not as quickly as previously expected.

Another reason for optimism, says Mr Rothenberg, is that online advertising is making obsolete the old distinction between marketing spending “above the line” and “below” it. In the jargon, above-the-line spending drives brand “awareness” (probably on television) or “consideration” by a consumer planning a purchase (probably in a newspaper). Such spending is often slashed in recessions. Below-the-line spending includes promotions or coupons to whet the consumer’s “preference” for the brand as he nears a purchase, or schemes such as frequent- flyer miles to increase his “loyalty” afterwards. These budgets are more robust.

Online marketing increasingly aims for awareness, consideration, preference and loyalty all at once. Mr Rothenberg gives the example of a rich-media ad for Kraft, a food company, in which a yummy image raises brand awareness, a click reveals a recipe that increases consideration, another click provides coupons and yet another click initiates a game that can be shared with friends. Marketing managers can therefore defend their online budgets as being both above and below the line.

The industry is also cautiously excited about two new forms of online advertising. The first is video. So far nobody has found a way to advertise inside online clips on a large scale. YouTube, which Google bought for no less than $1.65 billion two years ago, is “a huge end-user success,” says Eric Schmidt, Google’s boss, “and we’re awaiting the monetisation.” This is his way of saying that YouTube, despite showing 5 billion video clips a month, has trivial ad revenues. The site is experimenting with text “overlays” inside clips and sponsored videos for specific search terms, but it is early days. “If only we could schedule the revolution,” jokes Larry Page, one of Google’s founders.

If something close to one is in fact near, it may not come from YouTube. Ads on Hulu, a video site that is a joint venture between Mr Zucker’s NBC Universal and News Corp, another media giant, appear to be selling well. Hulu is different from other video sites in that it only shows professionally produced videos, such as programmes and films from NBC, Fox, MGM and Warner Brothers. It runs a relatively small number of short, fun “pre-roll” ads. These incorporate some of the advantages of the web. Viewers can, for instance, vote on how good a particular ad was.



The lesson appears to be that the problem was not the format but the fact that so much of the footage online, especially on YouTube, is “user-generated”. Brands are wary of putting their ads next to amateur clips because they may be boring or offensive. This is less likely to be a problem with professional content. From a small base, says Mr Rothenberg, online-video ads grew from 1% to 3% of all interactive ads in America in the first half of the year.

The other hope is for ads on social networks such as MySpace and Facebook. They are experimenting with a variety of advertising formats, though none has yet proved very successful. Their big weakness is that users go to social-networking sites to socialise, not to shop (as they might on search engines). Their biggest strength is that users spend so much time there. Two years ago 11% of time spent online was at Yahoo! and MSN, two web portals; now their share is down to 5%, and 5% of online time is spent at YouTube and Facebook.

Online traffic, in other words, is moving towards sites where advertising has so far proved ineffective and is therefore cheap. This, says Ms Meeker, presents an opportunity for innovation and arbitrage by clever marketing managers as they cut their conventional ad budgets. It may also provide a glimmer of hope for the advertising industry as it enters recession.

Mobile advertising

Madison, we have lift-off

Nov 27th 2008
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Advertising on mobile phones finally seems to be getting through

MARKETERS have often claimed that mobile advertising is taking off. But this time they could be right, recession or not. Global numbers are hard to come by, but a leading mobile-advertising firm, AdMob, says the number of advertisements it has delivered worldwide has tripled, to 4.5 billion, in the past 12 months. Why? Because many of the obstacles that have held mobile advertising back are going away.

One is hardware. For years, surfing the internet on a phone was a pain, because screens were too small and the controls too clunky. But a new generation of “smart” phones such as Apple’s iPhone, Google’s G1 and the BlackBerry Storm have solved this problem. They have touch-screens large enough to display the web properly—and advertisements, too.

Faster networks and lower rates also help. Having to wait for an advert to download, while being charged for the privilege, was unlikely to inspire warm feelings about the product being advertised. But with download speeds increasing and flat-rate “all you can eat” data plans, mobile services and applications are becoming more popular—and, increasingly, funded by advertising.

Perhaps most importantly, marketers are starting to work out which types of advertising work on mobile phones. Simple text-messages and banner adverts still dominate, but a more interesting idea is to spread the word using several channels. Amobee, a start-up, allows customers to insert adverts not just into text messages and mobile-internet sites, but also into games and other programs that run on handsets.

Another promising approach is to trade services for attention. Some of Amobee’s customers let people send free text messages if they allow them to insert advertising. Blyk, a mobile operator, offers subscribers—who must be between 16 and 24 years old—217 free text messages and 43 minutes of free airtime per month as long as they agree to receive six ads every day. A year after its launch in Britain, Blyk has signed up 200,000 subscribers—twice what it had aimed for.

Yet another approach is to combine mobile services with real-world events. This summer Phonevalley, a mobile-marketing agency owned by Publicis Groupe, an advertising conglomerate, offered a service that set up a teleconference between friends when their football team scored. It was sponsored by Puma, a sportswear-maker.

Advertising on mobile phones, like that on social-networking sites, presents risk and opportunity. The risk is that it can seem intrusive, since it appears in an intensely personal context. But that is also what makes it so attractive to advertisers—provided they can target their audience without seeming insensitive.

Economist.com BUSINESS

Mining

Kloppers clipped

Nov 27th 2008
From The Economist print edition

BHP Billiton ends its pursuit of Rio Tinto

“A DEAL for all seasons” was how Marius Kloppers, the boss of BHP Billiton, described his company’s bid for Rio Tinto, a rival Anglo-Australian mining giant. That was in August, before the chill of the credit crisis turned icy and the dark clouds of a global recession had begun to gather. On November 25th, after a year of reiterating the merits of the deal and several months into painstaking antitrust investigations by the European Union, BHP surprisingly decided to pull out.

This is a huge blow for the ambitious Mr Kloppers, who cuts an unusual figure in the mining industry: rather than being a rugged industry veteran with dirt under his fingernails, he is a sharp-witted former management consultant. He instigated the hostile advance on Rio in November 2007, barely a month after becoming BHP’s chief executive. Rio said his bid undervalued the company and maintained this position even when BHP raised its offer. At one point the all-share bid valued Rio at over $190 billion, which would have made the deal one of the biggest mergers in history. But it is a measure of the mining industry’s rapid reversal of fortunes that by the time BHP decided to abandon its pursuit of Rio this week, the value of its bid had shrunk to $66 billion. The decision to quit may pain Mr Kloppers, but the reasons for doing so have mounted steadily.

A year ago commodities were bubbling. But in the past few months prices have plummeted from record highs: *The Economist*’s index of metals prices has fallen by 55% since March. Mining firms’ share prices have tumbled too. Mining bosses were rightly wary of talk of a “supercycle” in an industry with a history of booms and busts, yet none would concede that China, its economy booming, was in any danger of losing its appetite for their products. In the event, a modest slowdown in China’s growth, coupled with a looming recession in the developed world, caused metals prices to collapse.

The fall in prices, and the corresponding impact on cashflow, meant that “it was just not the right time to be taking on the level of debt that exists on the Rio Tinto balance sheet,” Mr Kloppers said this week. Rio has around $40 billion in debt after its acquisition in 2007 of Alcan, a Canadian aluminium company. BHP’s debts are a more modest $6 billion. Although BHP had arranged a loan facility with its banks to cover the additional debt, it was evidently concerned about its ability to refinance the debt in future.

Mr Kloppers may also have underestimated the opposition of regulators. Had the deal gone ahead, around 75% of the market for seaborne iron-ore would have ended up in the hands of two firms, BHP-Rio and Vale of Brazil. Customers were worried that this concentration would give the mining firms even greater leverage when setting prices. The share prices of Chinese steelmakers jumped on the news that the deal had collapsed.

American and Australian regulators had given the deal their approval, but the EU’s competition authorities objected, and would probably have allowed it through only on the condition that BHP made significant divestments, in order to maintain competition in iron ore. But as Rio’s difficulties in unloading some of Alcan’s subsidiaries illustrate, getting decent prices for divested assets would been almost impossible in an industry paralysed by a dearth of financing. According to BHP, this difficulty was the second reason for giving up on Rio.

The EU was also thought to favour benchmark pricing as the fairest way to set iron-ore prices for steelmakers. The system allows them to sign contracts fixing the cost of their most important input for 12 months. But Mr Kloppers derides this system as “awful” and has been intent on dismantling the annual benchmark-price negotiations in favour of an index linked to the spot price, which had, until recently, outstripped benchmark prices for several years. Such is his commitment to breaking the old system that BHP has recently been testing indexed prices by selling iron ore on spot markets at well below contract prices. But this practice is unlikely to endure now that BHP has abandoned the deal.

BHP says it will write off costs of around $450m relating to its pursuit of Rio since mid-2007. Having

abandoned the mega-deal that has dominated his tenure so far, Mr Kloppers must now get back to the business of running his company.

Swings and roundabouts

Nov 27th 2008
From The Economist print edition

Boeing and Airbus are well placed to weather the recession

NOT a lot is going right for Boeing at the moment. A bitter 57-day strike by machinists at the aviation giant was settled at the end of October, but its effects continue to reverberate. Executives say they cannot gauge the impact on delivery schedules of commercial aircraft until a thorough review is completed. But so complex is the choreography of manufacturing big airliners that a ten-week delay is the best guess. At normal rates of production that equates to around 90 “lost” planes with an average list price of more than $100m.

To make matters worse, during the strike Boeing discovered a new problem with its bestselling but serially delayed 787 Dreamliner. And this time the elaborate global supply-chain established to make the plane—a big factor behind the strike—was not to blame. A mistake by Boeing engineers meant that the fasteners used to attach titanium structures, such as the floor grid, to the composite “barrel” of the fuselage were wrongly located. Some 8,000 fasteners will have to be replaced on each of the first dozen 787s before they can be completed, in effect freezing production until early next year. Customers are now unlikely to get their hands on a 787 until well into 2010, nearly two years late.

The difficulties with the 787 have spilled over into other programmes. This month Randy Tinseth, a senior Boeing executive, admitted that “limited engineering resources” would delay deliveries of the 747-8, a stretched 747 with an advanced new wing, by up to nine months.

By contrast, things seem to be looking up at Airbus, Boeing’s only rival in the market for large commercial aircraft. After a horrible run of bad news, the European consortium has regained some of its confidence. The cause of much of the recent trauma, the A380 super-jumbo, is winning rave reviews from both airlines and passengers, albeit two years late. And Airbus has at last moved to “wave 2” production in which the wiring harnesses that triggered the crisis are fitted automatically, instead of laboriously by hand.

A couple of weeks ago EADS, the parent company of Airbus, pleasantly surprised investors with third-quarter pre-tax earnings of €860m ($1.3 billion), having made a loss of €711m a year earlier. Part of the explanation is that the “Power8” restructuring plan is finally yielding results. But of even greater significance is the dollar’s new-found strength against the euro, which sent €960m to the bottom line.

This quarter should yield another improvement, assisted by the strike at Boeing. Airbus has not pinched any orders from Boeing, but according to Tom Williams, Airbus’s manufacturing supremo, overstretched suppliers who work for both firms could switch deliveries to Airbus. As a result, the production lines are flowing more smoothly, customers are more likely to get their new aircraft on time and Airbus will get a boost to its cashflow.

Both firms’ bulging order books—each has a backlog of more than 3,700 planes—are showing surprising resilience given the plight of most of their customers. Many airlines, especially in America, have begun deferring orders since the collapse of the oil price reduced the urgency of acquiring more fuel-efficient aircraft. But there have been few cancellations. Mr Tinseth says Boeing has only had two this year, and Airbus says it has had 119—more than half of which came last month when Skybus, an American budget carrier, folded.

John Leahy, the chief salesman at Airbus, denies reports that some airlines will have difficulty funding their purchases next year because of tight credit. He says there is still “a lot of liquidity in the market” and that banks understand that new aircraft are one of the least risky assets to lend on in “a deleveraged world” because they are mobile, have a long life and are standardised products. And if any airlines are having problems, both Airbus and Boeing are also ready to help with financing.

Mr Leahy adds that the airlines are much better equipped to cope with the falling revenues they are

suffering from now than with the rocketing fuel bills in the first half of the year, because they can always cut capacity to restore profitability. That may mean more orders are deferred, but juggling the manufacturing schedule is preferable to outright cancellations.

Mr Leahy and Mr Tinseth both expect new orders to decline next year, but at current rates of production, which neither firm has any intention of increasing, deliveries stretch out to 2015. For all their recent difficulties, Boeing and Airbus are well placed to weather the recession.

Retailing in America

Dreaming of a black Christmas

Nov 27th 2008 | NEW YORK
From The Economist print edition

American retailers and consumers fight to stay out of the red

Reuters



I'm off to Wal-Mart

EVEN the Grinch could not have engineered a more dismal set of circumstances for the start of America's holiday shopping season: entire industries are on the brink of collapse, the gyrations of the stockmarket have driven investors to despair, the days of easy credit are a distant memory and retailers are going bust. Black Friday, the day after the Thanksgiving holiday that is considered to mark the start of the Christmas shopping season, is supposedly so named because sales over the three-day weekend can bring in enough customers to lift many retailers out of the red and into the black for the year. As they try to lure customers through their doors, desperate shopkeepers are offering huge discounts.

This year it is not just the scale of the discounts that is notable, but also how early the price-cutting began. Many shops started their holiday sales in October. Some think this boosted sales, but others worry that it encouraged people to delay purchases and hold out for even bigger reductions. Darrell Rigby, a retail expert at Bain & Company, a consultancy, calls this "a high-stakes game of chicken" between customers and retailers.

Another trend this year is the expected decline in the popularity of gift cards, sales of which have grown at double-digit rates over the past five years. The collapse of retail chains such as Linens 'n Things and Mervyns, and the recent bankruptcy of Circuit City, are stark reminders that some shops may not be around in January to redeem gift cards. And the big discounts on offer this year mean that buyers may prefer to give things, rather than gift cards, as presents.

The past few months have shown the considerable power of Wal-Mart and mass discounters, such as Costco, to attract consumers with low prices. Britt Beemer, chairman of America's Research Group, a market-research firm, predicts that 40% of Americans will go to Wal-Mart to do some of their holiday shopping this year, and that 90% of those will do all their shopping there.

Shoppers are also turning to the internet to find the best prices and save on sales tax, which can be avoided with most online purchases. In the first ten months of 2008, 9% more was spent online than in the same period in 2007, according to comScore, another market-research firm. But its figures for early November show a 4% decline compared with last year. No one believes that the internet is going to save Christmas, since one of its effects is to hurt retailers that do not have the lowest prices. Empty windows and "for lease" signs are already scattered around gloomy malls. And one of America's largest mall-owners, General Growth Properties, said recently that it was close to bankruptcy itself.

American law firms

Shanghai, Dubai or Bye-bye?

Nov 27th 2008 | NEW YORK
From The Economist print edition

Prestigious firms face lay-offs, collapse and other indignities

ON DECEMBER 1st Thelen, one of San Francisco's most venerable law firms and until very recently one of America's 100 biggest, will cease to exist. At the end of 2007 the firm announced annual revenues of $345m, and a profit per partner of $805,000—barely 4% less than in the very lucrative year of 2006, and following a merger that had nearly doubled its size. Its demise will come just three days after the dissolution of Heller Ehrman, another giant San Francisco law firm. During the 20th century, these two firms handled the legal work that underpinned the construction of such tangible marvels as the Hoover Dam and the Golden Gate Bridge.

It is not supposed to be like this for lawyers, even during the worst of downturns. Though neither Thelen nor Heller can in fairness blame their woes on the economy alone, these days the bleeding is visible throughout the "AmLaw 200", the firms deemed by the *American Lawyer*, an industry journal, to be America's biggest 200 by revenue. At least 44 have laid off lawyers this year. Those who do keep their jobs blog bitterly about meagre bonuses and relocations under duress ("It's Shanghai, Dubai, Mumbai or Bye-bye," as the saying goes).

For although work has dried up in some areas—mergers and acquisitions, structured finance, property and construction—there is usually plenty of other business when the economy goes bad. Class-action securities-fraud litigation tends to soar in tandem with volatility on Wall Street and the blood pressure of fuming investors, for example. The trouble is that the counter-cyclical forces that were expected to save the skins of many firms, especially those that relied heavily on the financial industry, have yet to materialise.

A survey of litigation trends conducted by Fulbright & Jaworski, a law firm, shows a downward trend in the number of new suits filed against American companies: 21% saw none in 2007-08, compared with 11% in 2005-06. Investors, it seems, would rather not risk their cash on discretionary litigation. But among the law firms surveyed, 43% said they expected filings to increase in the next year, and only 3% expected a further fall.

A semi-annual report from the Stanford Securities Class Action Clearinghouse, due in January, will reveal whether the plunging stockmarkets are providing new work for those law firms that most miss their Wall Street clients. Joseph Grundfest, the Clearinghouse's director, expects that the sort of "bet-your-life law firms", the ones "dedicated to the legal equivalent of brain surgery" will keep their clientele intact. But the survival of companies such as Skadden, Wachtell and Cravath, which top the profits-per-partner rankings, will be no consolation to the "lesser elite" firms which also serve the *Fortune* 500, and which face a more uncertain future.

Mr Grundfest is not alone in speculating that the downturn will precipitate a shake-out among medium-sized firms. But some of these outfits, based outside New York and lurking beneath the AmLaw 200, spy opportunity. Wayne Risoli of Chamberlain, Hrdlicka, based in Houston, says his firm has poached at least eight *Fortune* 500 clients from bigger firms in the past year. GDF Suez, Black & Decker and Frontier Oil are among his firm's new customers—along with two *Fortune* 50 companies he prefers not to name.

Chamberlain has even been modestly expanding its staff as the bigger firms contract. Mr Risoli sees a simple explanation: his firm, and others like it, have long been used to price-sensitive clients and they have learnt to provide better value, he says. Their hourly rates are only 60-70% of those of the AmLaw 200's, and they tend to assign fewer lawyers to each case. Having come to Chamberlain for the first time under pressure from new budget restrictions, the big companies' in-house counsels have been impressed by its service. For anything less complicated than legal brain surgery, it seems, big companies are increasingly willing to give medium-sized law firms from out of town a chance.

Business in China

Going, Gome, gone?

Nov 27th 2008 | HONG KONG
From The Economist print edition

China's richest man disappears, and his company hits a wall

AP



WHATEVER your notion of what constitutes good corporate governance for a listed company, having an important executive arrested is a problem. But not even being able to say whether, or why, an executive has been arrested is worse. Such is the lot of Gome, China's largest electronics retailer, with 12% of the market, about half as much again as its nearest rival. In a few months Gome has gone from an example of extraordinary success, as it served China's pent-up consumer demand, to an example of the murky and fragile state of Chinese business.

Gome is in trouble partly for reasons beyond its control: the impact of an economic slowdown on clearly chastened Chinese consumers. But it is also at risk because of the way it is managed. In September Gome's founder and chairman, Huang Guangyu (pictured), was being described as Asia's equivalent of Sam Walton, the founder of Wal-Mart. The *Hurun Report*, a newsletter, calculated that he was China's richest man, with a fortune of $6.3 billion. Approximately $2 billion of that came from a 36% direct stake in Gome, and the rest from a hotch-potch of other investments in property, shares and an unusual private company that owns 450 of Gome's 1,300 branches.

Mr Huang's business dealings have raised questions in the past. In 2006 he was investigated in relation to a large government loan which was said to have funded Gome's initial growth. But other than an announcement of exoneration, details of the case were never disclosed. Any residual concerns were allayed to some extent by Gome's extraordinary growth. In the past two years it has bought out two rivals and opened more than 100 branches. Its revenues grew by 72% in 2007, and increased by 20% in the first nine months of this year, driven by demand for televisions to watch the Olympics and for washing-machines and refrigerators to furnish new homes.

Along with this growth, however, came an increase in debt, both to purchase inventory and to pay for expansion. Gome's share price started to fall in June, along with the share prices of other Chinese retailers, as it became apparent that China's housing boom was losing momentum. On November 18th, for no apparent reason, Gome's share price parted company from those of its competitors, and the slide suddenly became a rout.

Six days later a website run by *Caijing*, a business magazine, reported that Mr Huang had been detained by police on November 19th for insider trading in the shares of Shandong Jintai Group, a pharmaceutical company controlled by his brother, the share price of which had soared and then crashed last year. Police in Beijing confirmed that Mr Huang was under investigation, but did not give any further details. Other Chinese publications reported that Mr Huang had been detained as part of an investigation into bribes paid to government officials in exchange for the right to list on the Hong Kong Stock Exchange in 2004. Some reports suggested that political change in southern China, where Mr Huang is from, may have altered the regulatory environment to his disadvantage.

In the face of all this speculation Gome has been at a loss. The company could not even confirm whether or not Mr Huang had been detained, saying only that it was "making necessary inquiries" in an effort to "verify the allegations". Trading in Gome's shares on Hong Kong's stock exchange was suspended on November 24th. The stock exchange requires companies to provide information on factors which could affect the share price. Gome's response is that it cannot provide information it does not have—an argument that may provide legal cover, but is hardly reassuring. Mr Huang himself has vanished.

Gome's big suppliers have pledged their support for the company. They would certainly not want to lose

such a big distributor in today's difficult economic climate. Gome's accounts show that a large bond must be refinanced by May 2010. No one extends credit these days without feeling confident about the recipient. If Gome does not change, it will be gone.

Face value

From bad to great

Nov 27th 2008
From The Economist print edition

Lee Scott is stepping down having revived Wal-Mart's share price—and its reputation

Bloomberg



ONLY last year it seemed increasingly likely that Lee Scott's reign as chief executive of Wal-Mart would end soon, in disappointment and against his will. The world's largest retailer was suffering from slowing sales and falling profits in its core American market. Its share price had fallen by nearly one-third from its high in 1999, and a class-action suit filed by female workers, alleging systematic discrimination, had reinforced Wal-Mart's reputation as the firm sensitive Americans loved to hate. Mr Scott was floundering, his attempt to rebrand Wal-Mart as an eco-crusader widely dismissed as mere "greenwashing".

Yet such has been the transformation of Wal-Mart's fortunes since then that the announcement, on November 21st, that Mr Scott would step down as chief executive at the end of January was greeted with surprise. Nobody doubted that the decision to go, at the relatively tender age of 59, was entirely his own. Whereas most other bosses, especially of retailers, are struggling in what is shaping up to be the harshest recession for decades, Mr Scott is leaving on a high. Sales are expected to rise by some 8% in this financial year. The firm's share price, although down since September, is still about 20% higher than at the start of 2008.

The credit crunch has been Mr Scott's friend. Wealthier folk who used to turn up their noses at Wal-Mart now see its "every day low prices" in a new light. A strategy of refurbishing stores to make them more tempting to discerning shoppers, and expanding the range of products to cater to more sophisticated tastes, proved more prescient than Mr Scott could possibly have imagined. Sure, shopping at Wal-Mart will never offer the same delight as strolling in the wholesome oasis that is a Whole Foods Market, but in these times it is more than adequate, especially when you can buy the same organic yogurts for up to 30% less. Which is why Wal-Mart's popularity with higher-income shoppers has never been greater, and Whole Foods' share price has plunged by about three-quarters this year.

Good times had actually been the worst of times for Mr Scott, who was born in Kansas, joined Wal-Mart in 1979 and was soon heading its all-important logistics arm. He worked closely with the firm's founder, Sam Walton, before becoming only its third boss in 2000. He found himself grappling with a shift in consumers' demand, as they turned increasingly to less basic rivals such as Whole Foods and Target. His response seemed muddled as he hired marketing people whose lavish approach to business clashed with the austere culture built by old man Walton, and drifted away from the obsessive focus on driving down costs and prices that had made the firm great. In late 2006 Mr Scott decided to return the firm to its low-cost roots. As a result, Wal-Mart was perfectly placed when the economy started to slow, and price moved to the top of the consumer agenda.

Mr Scott's early years were also dogged by increasingly effective attacks on Wal-Mart's employment policies, notably its opposition to trade unions; the supposedly lousy pay and benefits of its 1.5m employees, whom it calls "associates"; and its aggressive store-opening programme, which critics complained drove many smaller retailers out of business. In 2005 Mr Scott decided to fight back, hiring an army of public-relations experts to point out the many benefits to society provided by Wal-Mart. At first this was received sceptically, but things started to change later that year after the company's impressive response to Hurricane Katrina, during which it delivered necessities to residents of New Orleans far more effectively than the government did.

This seems to have triggered something of an epiphany in Mr Scott, a straight-talker who hitherto had seemed more partial to sarcasm than tree-hugging. "What would it take for Wal-Mart to be that company, at our best, all the time?" he asked, concluding that in tackling environmental problems in particular there was an opportunity to make the "very things people criticise us for—our size and reach" into "a trusted friend and ally to all." This was not fundamentally an altruistic decision, but rather a chance to hit back at Wal-Mart's critics and make money, whilst also doing good. The firm started selling environmentally friendly products such as low-energy light bulbs, reduced its use of wasteful packaging and said it would switch to renewable energy—all things that could boost Wal-Mart's bottom line.

The greening of Bentonville

A growing number of eco-warriors have become convinced that the firm is sincere, and that its scale gives it the potential to have a hugely positive effect on the environment. On November 19th, at a conference on corporate citizenship hosted by *The Economist*, Jeffrey Hollender, the boss of Seventh Generation, a green household-products firm, said that after three years of exhaustive talks he had just lifted a self-imposed ban on selling his products at Wal-Mart because, despite having "a huge negative footprint", Wal-Mart is now unambiguously "on the right trajectory".

Some critics say Mr Scott is stepping down before Congress makes it easy for unions to be formed at companies, such as Wal-Mart, that prohibit them. Perhaps a more union-friendly boss is needed to navigate the choppy waters ahead. That said, Mr Scott told a recent gathering of 1,000 suppliers in China that their firms would be held to high standards on labour practices. He has also struck up a useful working relationship with Andrew Stern, president of the SEIU, a big union, to campaign for health-care reform in America. In the end, the likeliest reason why Mr Scott is stepping down is timing. Wal-Mart's performance and reputation have never been better, and there is little for him to gain by staying on. The culture is transformed; the strategy is in place; his reputation glows. If the recession proves deep enough to prompt its customers to make further cutbacks, Wal-Mart may yet find itself grabbing a bigger slice of a fast-shrinking cake. But Mr Scott is leaving that potential problem to Mike Duke, his successor.



FINANCE & ECONOMICS

Unorthodox economic policies

Plan C

Nov 27th 2008
From The Economist print edition

As their economy slides, America's policymakers are turning to unconventional devices. Our first article looks at the bold new steps taken this week by the Federal Reserve and the Treasury. Our second examines policy in Europe

Illustration by James Fryer



THE Federal Reserve's interest-rate target is at 1%. The recession is deepening. And the question is being asked repeatedly: when will America's economic policymakers start using truly unconventional measures to stimulate the economy?

The answer is that they already have. Without making any formal declaration, since early September the Fed has expanded its balance-sheet rapidly to counter the credit crunch. Under the guise of successive new programmes, each with a less memorable acronym than the last, the Fed is substituting its balance-sheet for that of the contracting private financial system to keep the American economy from being starved of credit. This week the central bank and the Treasury unveiled their latest big initiatives.

America's financial system is undergoing a radical reassessment of what are acceptable levels of capital, leverage and interest rates. Some institutions have failed; those that have not are intent on reducing their leverage (ie, their volume of loans for each dollar of capital). The Fed has no hope of stopping this: it is merely trying to slow it down, by providing a home for the assets that the financial sector is shedding. The alternative would be plunging asset values, a complete withdrawal of credit and economic catastrophe.

Ben Bernanke, the chairman of the Fed, has repeatedly promised to use "all of the powers at our disposal" to get credit flowing again. This week's initiatives are another demonstration of what he means. The Fed and the Treasury agreed to guarantee $306 billion-worth of assets belonging to Citigroup (see article). They then created a $200 billion facility to purchase asset-backed securities. Most radically, the Fed promised to buy up to $500 billion-worth of mortgage-backed securities (MBSs) guaranteed by government-sponsored enterprises (GSEs), including the now nationalised mortgage agencies, Fannie Mae and Freddie Mac, and up to $100 billion-worth of their direct debt. The effect was immediate: yields on the securities plunged by 40 basis points, and the 30-year mortgage rate fell from a shade over 6% to 5.8%.

Paying the Fed

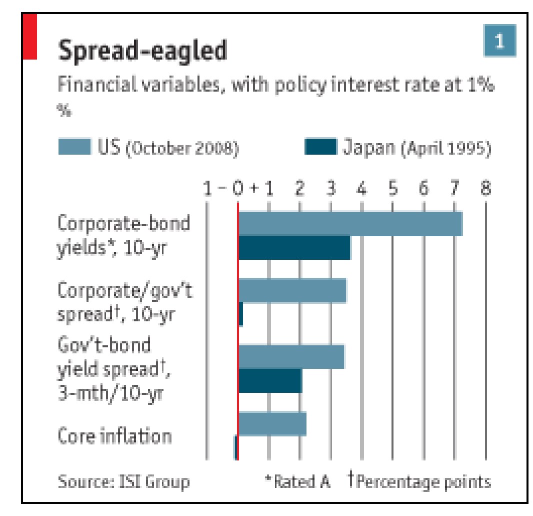
The MBS purchases are significant; for the first time they turn the Fed into a direct lender to consumers. Many homeowners, though they do not know it, will be sending their monthly mortgage payments to the Fed. The Fed will finance these programmes with newly created reserves: that is, it will print money. Its balance-sheet, which has ballooned from $900 billion to $2.2 trillion since August, could grow by another $800 billion, making it a larger lender than any commercial bank.

It is tempting to look to Japan for a map of where the Fed may be heading next. Faced with sinking asset prices, insolvent banks, moribund growth and deflation, the Bank of Japan (BoJ) eventually lowered its policy rate to zero in 1999. In 2001 it announced "quantitative easing": through large-scale purchases of government bonds, it would fill the banks with excess reserves that it hoped they would lend out, stimulating loan growth.

These routes are open to the Fed. It could cut its federal funds rate target from 1% to zero, though that would make it hard for some parts of the money market to function. It may not do much good, since the actual funds rate is already trading well below the target. To give it more impact, the Fed could commit itself to keeping the funds rate at zero for some time or until the economy or inflation meet some predetermined conditions. Such a commitment could drag down long-term Treasury-bond yields. Academics have concluded that Japan's quantitative easing had little benefit except to buttress expectations that its policy rate would be zero for a long time. Alternatively, the Fed could target long-term rates via purchases of Treasuries, as it did from 1942 to 1951. That strategy could gain in appeal if big government deficits start to press bond yields higher.

Yet these options are not the most appealing for the Fed. The reason is that while it, like the BoJ, is now involved in a form of quantitative easing, it is doing so with completely different goals and in a very different environment.

One way to see this is to compare Japan in April 1995, when the BoJ's policy rate was 1%, with America in October (see chart 1). Core inflation was slightly negative in Japan at the time, against 2.2% in America last month. That means real interest rates were significantly higher and conventional monetary policy less stimulative in Japan than in America today, says Tom Gallagher of ISI Group, a broker-dealer, who made the comparison.



Frozen by fear

Where America fares worse is in credit conditions. In 1995 Japanese corporate-bond yields were just 16 basis points higher than government-bond yields; the spread in America last month was 350 basis points. In a nutshell, Japan's problem was deflation and moribund investment; America's is rising fear of default, illiquidity and the need of so many lenders to reduce leverage, which collectively are choking off private credit and blunting conventional monetary policy. Although the federal funds rate target is far below the 5.25% of last summer, mortgage rates are only a little lower (see chart 2). Corporate borrowing rates are much higher.

The change in the perception of credit risk since the crisis began is similar to the change in the perception of terrorism risk after September 11th 2001. What investors once deemed safe levels of capital and liquidity they now consider dangerously thin. Before, banks "had just-in-time capital available, just-in-time funding...a lot of liquidity," Vikram Pandit, Citigroup's chief executive, said this week, "We've gone from that to, if you really need sizeable funding, you have got to go to a central bank. If you need to raise a lot of debt, you need an FDIC guarantee." (The FDIC, or Federal Deposit Insurance Corporation, is a bank regulator.) Citi's assets, which peaked at $2.4 trillion a year ago, were down to a little over $2 trillion by the end of September. With the Treasury's injection of equity this past week, Citigroup's core capital is now almost 15% of total assets, once an astronomically high ratio but one that many banks will now be expected to attain.



The pressure on investment banks to reduce leverage is even greater, because they rely more on fickle wholesale funding and less on stable, federally insured deposits. As a firm that depended heavily on proprietary trading and underwriting, Morgan Stanley boasted $33 of assets for each dollar of capital a year ago. By the end of October, the leverage ratio was below 16, according to the company. To get it there it both raised new capital (from sources including the federal government) and shrank its balance-sheet, to "significantly less" than $800 billion by the end of October from more than $1 trillion in May. "Clearly we're in a world of reduced leverage," Colm Kelleher, the firm's

chief financial officer, told investors recently.

The deleveraging of firms like Morgan Stanley and Citigroup creates problems for borrowers throughout the economy because the yields on the assets they sell rise. Borrowers must fight for a shrinking supply of new credit. Those that get it must pay far more. The rest cancel investments, lay off employees and hoard cash.

Initially Mr Bernanke sought to ease the pressure to deleverage by offering to finance banks' holdings of illiquid securities on easy terms. But investors began to question the ability of bank capital to withstand a wave of recession-related defaults. The Treasury's Troubled Asset Relief Programme (TARP) aims to quell those fears by injecting equity into banks so that they can reduce their leverage without shrinking their balance-sheets.

However, there are limits even to this. The Treasury has stuck to purchasing preferred equity to minimise the risk of loss and avoid having any say in running the bank. But the high interest rate the Treasury receives on such stock reduces banks' profits. And rating agencies and regulators consider preferred stock a less permanent and therefore inferior form of capital to common equity.

Simon Johnson, an economist at the Massachusetts Institute of Technology, thinks the Treasury should start purchasing common equity instead, as the British government has done. With banks' market values so low, that would leave the government with large stakes, and perhaps majority ownership of some banks. Mr Johnson suggests creating an arm's length control board to oversee the government's ownership, free of political meddling.

Still, helping banks recapitalise only partly mitigates deleveraging. Many large buyers of debt assets have simply disappeared, such as "structured investment vehicles", or SIVs, that used short-term financing to buy up asset backed securities, often from banks seeking to free up capital. At one point they held up to $400 billion in assets. But, unable to roll over their funding, they have been either reabsorbed by banks or closed. In October one of the last big SIVs, Sigma Finance Corporation, with $27 billion in assets, collapsed. Its liquidation by creditors is thought to have contributed to the plunge in prices of asset-backed securities which has made it impossible for new securities backed by student, credit-card and car loans to be issued.

When the average person hears the term "asset-backed securities" he may well think of some of the crazier structures built on the rickety base of subprime mortgages. That would be wrong. Securitisation is decades old, mundane and vital. Banks and other lenders routinely pool their student, car, small-business and credit-card loans, and residential and commercial mortgages into securities and sell them to investors, leaving room for them to make new loans. The deleveraging of banks may be inevitable and healthy, but the disappearance of the securitisation market is not. Without it, "millions of Americans cannot find affordable financing for their basic credit needs," Hank Paulson, the treasury secretary, said on November 25th. The facility he and the Fed unveiled that day will buy up to $200 billion of newly issued, top-rated asset-backed securities. The TARP will absorb the first $20 billion of losses; the Fed will lend the rest. It may eventually purchase commercial and residential MBSs that are not guaranteed by a GSE.

The facility may thus eventually do what TARP was meant to: relieve banks of their illiquid assets. But it does so by in effect leveraging each TARP dollar many times over via the Fed's balance-sheet. "Policymakers seem to have concluded that leverage got us into this mess and leverage can get us out," quipped Stephen Stanley, an economist at RBS Greenwich Capital. "Is it just me, or can you see a future for these guys running a hedge fund?"

The Fed's decision to purchase MBSs is in some ways even more radical: it represents a direct foray by the Fed into lending to consumers: Though it has had the authority to buy the MBSs and debt of Fannie Mae or Freddie Mac since 1966, it has not done so since 1997 for fear of conferring government backing to ostensibly private companies. Those concerns disappeared when the Treasury in effect nationalised the companies in September.

Illustration by James Fryer

The Treasury and the agencies themselves had been buying MBSs but in spite of that the yields continued to rise, in part because of the government's mixed signals on whether it stood behind the companies. The Fed's announcement carries clout because of the size. There is no reason why the Fed need stop at $500 billion; between them, Fannie and Freddie have $4 trillion of MBS outstanding and $17 billion of their own debt. In going further, the Fed would in effect take over the roles of the mortgage agencies

itself. And in theory, it could find creative ways to do the same for the corporate-bond market. Mr Bernanke is willing to try almost anything.



Yet these strategies do carry risks. One is inflation. Having expanded its balance-sheet so rapidly, the Fed may not have the foresight or courage to shrink it fast enough once the crisis passes, and the extra liquidity could fuel an overheating economy. But with unemployment perhaps heading for 9%, from 6.5% now, that risk seems remote.

Another risk is that the Fed and the Treasury have taken on more commitments than they can credibly keep. With budget deficits that could top $1 trillion a year, plus trillions of dollars more in guarantees to mortgages and bank debt, some investors may question America's ability to shoulder all this debt. They could react by selling the dollar, although with the entire world in recession, the lack of appealing alternatives makes that less plausible.

More likely, they could just back away from Treasury bonds until the yields rise enough to compensate them for the higher risk of default. Ireland represents a cautionary tale: since it guaranteed the debts of its banking system, credit-default swaps have widened sharply on its sovereign debt, implying rising concern that the Irish government may one day default. America is a much bigger country and its currency happens to be the world's premier reserve currency. So it can print as much as it likes. For now, anyway.

Policy in Europe

Those reluctant Germans

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From The Economist print edition

Europe is struggling to put in place even a conventional fiscal stimulus

IF THE worst fears of a severe global recession are realised, historians may look back and wonder why the region with the most scope to allay a downturn seemed unable to exploit it. The euro area's collective budget deficit was 0.6% of its GDP last year, according to the European Commission, a picture of health compared with America and Britain. On November 26th the commission unveiled a plan for a co-ordinated fiscal stimulus across the European Union worth €200 billion ($258 billion). It set out policies—temporary cuts in employment and sales taxes, more generous state support for the low-paid and jobless, and so forth—that might best give the economy a short-term lift. The proposals will be discussed at an EU summit in December, but the chances that they will be adopted in full seem slim.

Some reluctance to prime the fiscal pump may seem reasonable. The orthodoxy for three decades has been that monetary policy is the best tool to manage the economic cycle. It is easier to reduce interest rates in a timely way than to fiddle with tax schedules. Furthermore, there is still room to loosen monetary policy in Europe: even after recent reductions, interest rates are 3.25% in the euro zone and 3% in Britain. And both the European Central Bank (ECB) and the Bank of England have, like the Fed, proved willing to expand their balance-sheets, if not to the same degree, in order to provide liquidity to their banking systems.

Public spending is hard to ramp up quickly and harder still to cut when the economy recovers. Much of the benefit may leak to neighbours who do not bear the cost. Europe also has a more solid fiscal buttress. The public sector accounts for a much bigger slice of GDP so a drop in private spending has proportionately less impact on the economy. State benefits for the unemployed are larger than in America, so public spending rises by more in a downturn. Tax receipts are bigger too and they tend to fall quickly in downturns, providing an automatic fiscal relief for taxpayers.

For all that, there is still a strong case for an active fiscal policy. The impact of interest-rate cuts is blunted by the sickliness of banks, the link between central-bank policy and the wider economy. Even if bank credit were cheaper and freely available, a collapse in confidence and asset prices means firms and households are inclined more to save than to spend. For these reasons Mervyn King, the governor of the Bank of England and a pillar of policy rectitude, has endorsed Britain's fiscal stimulus. The bank's chief economist, Charlie Bean, told politicians this week that the frailties of the financial system mean interest rates may need to be cut "aggressively".

Policymakers in the euro area seem instinctively wary about such policy activism. Germany's government has low borrowing costs and a broadly balanced budget, so is best placed to throw some cash around. But the fiscal package it announced earlier this month was modest—€12 billion over two years, just 0.25% of GDP. And on November 26th Angela Merkel, the German chancellor, hit out at those who say Germany should do more and criticised the loosening by other countries. The commission made it clear that the prospect of a deep recession means the rules that cap budget deficits at 3% of GDP will not be applied rigidly. That gives France and Italy, which are close to the limit, some room for manoeuvre. But Germany would need to play a big role in the commission's plan, worth 1.5% of EU GDP. "If Germany plays a tight game, it makes it harder for other countries to loosen their fiscal policy," says Mark Wall, an economist at Deutsche Bank.

The ECB seems a bit cautious too. On November 25th Lorenzo Bini Smaghi, a member of the bank's rate-setting council, argued that slashing interest rates to insure against a deep downturn can harm confidence, as well as limiting policymakers' future options. Still, the ECB is likely to cut interest rates on December 4th. So is the Bank of England.

But the degree of unorthodoxy being contemplated in America seems a way off. A money-financed tax cut, for example, would require co-operation between national governments and central banks, and would have to be consistent with explicit inflation objectives. That may prove easier in Britain than in the euro

area, where co-ordinating even a conventional fiscal stimulus between 15 separate countries is proving so tortuous.

Citigroup

Singing the blues

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From The Economist print edition

A flawed rescue keeps America's most iconic bank afloat. Now it must show it deserves to exist

Illustration by S. Kambayashi



WHEN Citigroup was formed a decade ago, in a merger that reshaped banking, the deal's architect, Sandy Weill, basked in the limelight and admitted to feeling like a rock star. The boss these days, Vikram Pandit, must feel more like a busker. Humbled by a devastating, Lehmanesque run on its shares, Citi has become the latest, and largest, financial institution to need rescuing. The giant bail-out gives the bank breathing space. But it also leaves Citi in what a prominent financier calls a “financial no-man's-land”: still too leveraged for comfort and too cumbersome to manage effectively, yet far too big to fail.

The rescue comes in two parts: it provides $40 billion in fresh capital and capital relief, and it ring-fences $306 billion of illiquid assets on Citi's $2 trillion balance-sheet. The bulk of any losses on these, beyond the first $29 billion, will be borne by government agencies. One official describes the arrangement as “catastrophe insurance” for Citi. The deal, a new version of intervention in a crisis that has already seen a few, is the strongest sign yet that the government will do whatever it takes to maintain confidence in banks, says Torsten Slok, an economist at Deutsche Bank.

The immediate benefit is to reinstate Citi as a trusted trading partner: though there was no doubt it would be propped up, clients had begun to pull money. And the loss-sharing agreement leaves the bank with a substantial capital surplus, if (a big if) you trust the way it values its dodgier assets. But the plan, crafted in a hurry over a weekend, has several flaws.

Ain't no sunshine

First, no one has been forced to take responsibility for Citi's woes. Keeping Mr Pandit on was understandable: in the job for less than a year, he was dealt an awful hand. But the longer-serving board has plenty to answer for; and Robert Rubin, formerly head of its executive committee (and professionally close to both the outgoing and incoming treasury secretaries), encouraged its disastrous foray into collateralised-debt obligations. Shareholders also get an easy ride. Losing the dividend for three years is a small price to pay for not being all but wiped out, as has happened in previous rescues, such as that of American International Group, a giant insurer, and Fannie Mae and Freddie Mac, the two vast mortgage agencies.

Moreover, the deal marks a return to the patch-by-patch approach that preceded the $700 billion Troubled

Asset Relief Programme, or TARP. This may have been unavoidable, given the ferocity of Citi's decline. But it sows uncertainty, just weeks after the government attempted to bring more coherence to its bail-out policy.

Third, it is not big enough to guarantee that Citi can avoid returning to the trough. The cloistered $306 billion includes the bank's most noxious holdings, such as mortgages, commercial-property loans and leveraged loans. But its huge credit-card and overseas-loan portfolios remain outside, and are degenerating fast. Nor are Citi's off-balance-sheet exposures—$1.2 trillion at the end of September—included.

Some facets of the deal look like smoke and mirrors. It releases $16 billion in regulatory capital to Citi, by giving a generous 20% risk-weighting to the partially insured assets (previously booked at 100%). As a result, it will have to hold a mere $5 billion of tier-one capital against 60 times that in questionable debt, on which it must bear the first $29 billion in losses.

Last, the rescue does nothing to establish a clearing price for the impaired assets on banks' books. This was the original aim of the TARP, using auctions, but it was dropped earlier this month in favour of direct capital injections. Officials would like to see Citi and others using their excess capital to buy securities cheaply in the secondary markets—in other words, to take on the role the government abandoned. For the time being, this is a vain hope.

Imperfect though it is, the rescue appears to have been designed to be used as a template for future interventions. "This is now the most effective way to show our commitment," insists an American financial regulator. It may also be expedient for the Treasury, which has only $20 billion left from the first $350 billion tranche of the TARP—Congress is yet to release the second half—since the new approach rests primarily on insurance, not hard cash.

But is it the right approach? Some would have preferred to see Citi hive off its troubled assets into a separate "bad bank", tasked with disposing of them in a way that minimised downward pressure on financial markets. This approach worked well in several past financial crises, including Sweden's in the 1990s (see article). In this one, it has been used to unburden UBS of up to $60 billion of dross, which will be managed by the Swiss central bank.

In economic terms, the bad bank may be little different from the type of backstop used by Citi; in both cases, toxic holdings are isolated. But a bad bank may have a more positive psychological impact on markets, because it signals a clean break. It also removes a big distraction, allowing managers of the good bank to focus on the healthier businesses. On the other hand, bad banks can be difficult to set up in the thick of a crisis, when it is still unclear which assets should be transferred. And for the institution being helped, it reduces the potential upside, should values recover. Citi will reap gains from some of its walled-off assets as markets stabilise.

But that is for the distant future. For now, Citi's challenge is to regain its balance. Then it will have to prove that it has become less accident-prone. The bank has been heavily involved in most of the past quarter-century's nastiest blow-ups, from the sovereign-debt defaults of the 1980s to the dotcom bust. It was even temporarily banned from launching new takeovers in 2005, after a string of regulatory lapses. Built in a hurry by Mr Weill, the group that Mr Pandit inherited lacked a solid culture. Its risk management was not up to scratch. Its investment bank was a patchwork of acquired shops and poached teams. "It was the greatest roll-up in history, but it is yet to sing," admits a Citi executive.

The genial Mr Pandit is working on creating more harmony and tightening controls. He has also shaken up the way Citi allocates capital and pledged to cut staff numbers by 20% as part of a broader overhaul. He wants Citi to go back to doing "the basics"—retail banking, corporate services, merger advice—really well. That would seem to rule out a much talked about tie-up with Goldman Sachs, dubbed Sachs and the Citi.

But he has admitted he could have moved faster, and more dramatic action may now be needed. Though they have made no explicit demands, regulators want a slimmer, safer Citi. Shareholders want to see proof that the financial-supermarket model works, or else a break-up. For what is the point of a bank that is too big to fail but too unwieldy to succeed?

Bank bail-outs

Stockholm syndrome

Nov 27th 2008
From The Economist print edition

Bad banks were a big part of Sweden's 1990s rescue package

"US OLD guys are really being dusted off at the moment," jokes one architect of Sweden's successful bank bail-out in the early 1990s. Maybe so, but policymakers, particularly in America, are still taking an age to learn their Swedish lessons. The country took a comprehensive approach to its crisis, not only guaranteeing debts and injecting government cash into banks that could not raise private capital, but also setting up "bad banks" to manage institutions' toxic assets. The Citigroup rescue edged in this direction; UBS is setting up a bad bank with Swiss government money. But there is further to go.

The idea of a bad bank, a separate entity which takes ownership of non-performing assets and then manages them in order to maximise their value, is simple enough. The Swedes set up two bad banks (with the reassuringly solid names of "Securum" and "Retriva") to handle the crummier assets of Nordbanken and Gota Bank, two nationalised institutions. And very effective they were (indeed, some borrowers complained they were too ruthless). Their efforts to restructure and sell distressed loans helped Sweden to keep the eventual cost of its bail-out below 2% of GDP.

One advantage of the bad-bank structure is neatness. Taking toxic assets off the balance-sheet leaves behind a cleaner bank which should find it easier to raise capital or attract buyers. Another is specialisation. According to Jonathan Macey, a professor at Yale University, the genius of the Swedish scheme was that it allowed people who were good at restructuring bad loans to focus on that job, and those who were better at running banks to concentrate their efforts there.

Things are more difficult today. The Swedish loans were much less complex than modern securitised assets. Pricing the assets was also easier because taxpayers were on both sides of the deal, owning both the nationalised good banks and the bad banks. Nor was the rescue a panacea: Swedish bank lending to the private sector contracted for years after the intervention. But ugly as they sound, bad banks are a good idea.

Private equity

Get a grip

Nov 27th 2008
From The Economist print edition

The hollow bullishness of buy-out firms' bosses

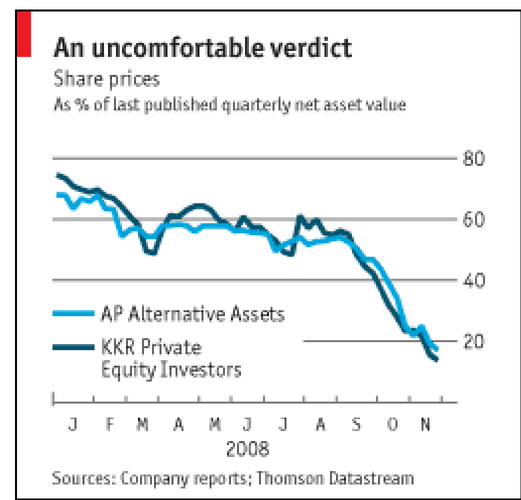
LIKE professional wrestling, private equity has a butch subculture that is hard to take entirely seriously. One of its defining characteristics is never, ever, to admit to a mistake in public. By convention, most buy-out bosses maintain that they anticipated a recession and acted cautiously. In reality, the buy-out industry had its biggest-ever binge just before the bust began. Most big firms paid silly prices for companies using sillier levels of debt. A reminder of just how reckless some deals were was provided on November 26th by BCE, a Canadian telecoms firm and the target of the second-largest buy-out bid on record. Its auditors judged that if the transaction went ahead the company would become technically insolvent.

As more companies owned by private-equity firms go bust, the industry will have to admit its sins. Until then executives can enjoy the latitude created by the valuation conventions that govern their portfolios. Accounting rules require that investments are held at "fair value"—the price at which they can be sold to a third party in an orderly transaction. Valiant efforts to interpret these rules are being made by the International Private Equity Valuations Board, an industry body that some buy-out firms support. But the calculations involve inevitably subjective comparisons with quoted companies. Conflicts of interest are possible: some buy-out firms' in-house dealmakers conduct valuations, which are reviewed by consultants and auditors and approved by senior executives.

Just how optimistic are these valuations? In the nine months to the end of September, developed-world shares dropped by about a quarter in dollar terms. Given their extra leverage, that is consistent with a fall in the value of companies owned by private equity of well over 50%. Yet Blackstone has said that its private-equity portfolio fell by just 13%. Two Dutch-listed vehicles run by Kohlberg Kravis Roberts and by Apollo, which have high exposures to boom-era deals, have both reported drops of about a quarter in their net assets.

Private-equity firms maintain they bought defensive firms which are being run better than quoted peers are. But the limited price signals available also suggest low confidence in their valuations. The loans that funded the big deals typically trade at three-quarters of their face value, implying distress. The shares of the two Dutch-listed vehicles are worth less than 20% of their net asset values (see chart). Trading in all of these instruments is admittedly very illiquid, but the implication is hard to ignore.

However clear, does this message actually matter? It is hard to see why private-equity firms feel they need to be defensive about falling valuations. After all, they are paid if and when they sell companies for a profit, not on the basis of current marks. They lock in their clients' capital for many years and do not face the collateral calls and liquidity squeezes that make hedge funds so sensitive to calculations of net asset value.



The same cannot be said of the pension funds and endowments that invest in private equity. Even if they hold investments to maturity, they should care about their current value. And given the collapse of all asset classes (with the exception of private equity, of course) they are now being forced to reshuffle their entire portfolios. Using unrealistic values for their private-equity stakes pollutes this process. Many may choose to lower the absolute value of private-equity investments in their portfolios and concentrate their holdings on the best-performing funds. All of this requires accurate valuations. It is striking that so-called "secondary" sales by clients of stakes in buy-out funds are reputedly taking place at large discounts to their reported values, although again trading remains very thin.

In the end pressure for consistent and conservative valuations must come from clients. Still there are some signs that private-equity firms, behind the scenes, are preparing for a downturn far more severe than their valuations suggest. James Hickman, a private-equity specialist at Russell Reynolds, a headhunter, says that requests from buy-out firms to find operational managers have risen by 30-50%. Veterans with experience of recessions or of restructuring companies are in hot demand. As are, hopefully, straight talkers.



FINANCE & ECONOMICS

Buttonwood

The issuance issue

Nov 27th 2008
From The Economist print edition

It will not be easy to find a market for all that government debt

Illustration by S. Kambayashi



“ROLL up, roll up. Get your government bonds here. They may not pay much, but they’re safe. Buy ’em now in case stockmarkets don’t last.”

As the recession deepens, finance ministers round the world may be forced to resort to the tactics of the market stallholder. Politicians hope that deficit financing will be the way to stimulate the economy. But someone has to buy all those bonds.

They are easy to sell at the moment. The prices of risky assets like shares and corporate bonds have been plunging. Banks are so desperate for the security of government paper that they are accepting yields close to zero on three-month Treasury bills. Yields on American ten-year Treasury bonds have fallen to around 3%, their lowest in a generation. British government bonds, or gilts, with the same maturity are returning about 4%, despite the rise in the budget deficit planned by Alistair Darling, the chancellor.

Government-bond markets are benefiting from the deteriorating economic outlook, which is leading some forecasters to predict both a recession and a brief period of deflation in 2009. A nominal yield of 3-4% looks attractive in real terms if prices are falling.

But will this appetite continue as governments churn out more debt? Citigroup is forecasting a 40% increase in bond issuance in the euro zone and a doubling of issuance in America. Moyeen Islam, a bond strategist at Barclays Capital, says the British government plans to issue £369 billion ($585 billion) of debt over the next seven years. That is almost as much again as the face value of outstanding conventional gilts, which stands at £460 billion.

A surge in supply could be matched by higher demand. The potential precedent is Japan, where nearly two decades of fiscal deficits and a deteriorating debt-to-GDP ratio have not stopped investors from buying bonds at yields of less than 2%.

But is this really an encouraging example? Most Americans and Europeans would not consider low government-bond yields to be adequate compensation for the nearly two decades of sluggish economic growth that Japan has suffered. And Japan is different from America and Britain: it runs current-account surpluses and thus has not been dependent on foreign capital. The Anglo-American economies rely on the

kindness of strangers.

There has been no sign, so far, that foreigners are tiring of funding the American deficit. Indeed, the dollar has risen against most currencies (the yen is a notable exception) in recent months. Being the world's largest economy has helped, as has the flight out of emerging-market currencies. But Britain does not have the same advantages. The pound was treated for many years as a high-yielding version of the euro. That is no longer so after recent rate cuts and sterling has suffered against both the euro and the dollar.

Mr Islam reckons overseas investors have been buying around 30% of recent gilt issuance. Given the losses they have already suffered through the pound's fall, will they step up their purchases, especially as the growth rate of global foreign-exchange reserves is slowing?

So domestic investors may be required to shoulder the burden. Pension funds may be eager to add to their holdings, given the losses they have suffered on shares and in alternative asset classes, such as hedge funds and private equity.

But retail investors may also be needed. A rise in the savings rate is widely forecast as the economy slows (although this is likely to be driven by a fall in borrowing more than by a surge in savings itself). If, as many economists forecast, the Bank of England cuts short-term rates to 2%, British savers could be tempted by the allure of government bonds yielding 3-4%. The same may be true in America, where money-market funds are already offering paltry returns. This will be a big change of habit: according to Morgan Stanley, America's net Treasury-bond purchases, outside those by the finance industry, have been zero since 1992.

Perhaps a more cautious generation of investors will rediscover the virtues of government debt, as they did in the 1930s and 1940s. "People will be buying bonds as Christmas presents," predicts Matt King, a credit strategist at Citigroup.

Paradoxically, the real problem for governments may only occur if they manage to revive their economies. At that point, deflation worries will disappear and investors will switch to riskier assets. Given the deficits in both Britain and America, it seems unlikely that any cyclical rebound will be strong enough to bring the budget back to balance. In 2010 or 2011, issuing government bonds may prove a much harder (and more expensive) task.

French banking

Bad harvest

Nov 27th 2008 | PARIS
From The Economist print edition

Big banks eye the retail deposits of France's accident-prone mutuals

OVERALL, French banks have had a good credit crunch. No French institution has had to be rescued by the state. There has been one big bail-out, of Dexia, a Franco-Belgian lender, but France's finance minister, Christine Lagarde, was quick to assert that the bank was in fact Belgian by capital and supervision. France has set aside €40 billion ($52 billion) to boost capital, but only a quarter of that has been requested by banks, a fraction of the sums pumped into American, British and German lenders. And BNP Paribas has emerged as one of the main winners from the crisis. In October it snapped up the Belgian assets of Fortis, a Belgo-Dutch bank, for a bargain price, and became the biggest bank by deposits in the euro zone.

Its listed rival, Société Générale, has had some bruising experiences, such as losing €4.9 billion in a rogue-trading incident in January. But unexpectedly, France's mutuals, traditionally conservative institutions who normally lend small sums, have come out the worst from the crisis. In recent years the mutuals aggressively sought to increase their presence in investment banking. In 2004, for instance, Crédit Agricole hired Marc Litzler, a star from Société Générale, to turn Calyon, its investment bank, into a global player. In 2007 Calyon suffered a €250m hit from rogue trades in its New York office. During 2007-08 Crédit Agricole took pre-tax write-downs and provisions of €6.4 billion relating to America's subprime crisis, more than any other French bank. The losses nearly cost the job of the bank's chief executive.

The latest mutual to stumble is Caisse d'Epargne, France's third-largest retail bank, whose top management resigned in October after admitting a loss of €600m on equity derivatives. Caisse d'Epargne was negotiating the terms of a merger with Banque Populaire, a smaller mutual, and will now have far less clout in the discussions. The merger is in part designed to shore up Natixis, an investment bank that they jointly own. It was forced into a €3.7 billion rights issue in September after heavy losses in the subprime crisis.

Bankers reckon that the number of incidents at the mutuals indicate an underlying problem with their ability to handle investment banking. "On the face of it, the major failings in risk management have occurred more at the mutuals than at the listed banks," says Nicolas Véron of Breugel, a think-tank in Brussels.

One problem, says Wim Fonteyne, an economist at the IMF who has studied European mutual banks, is that a large chunk of their capital is not owned directly, since their members are entitled only to the initial, nominal value of their shares, not to the banks' vast reserves of retained earnings. Having big pots of money with unclear ownership "can encourage risk-taking in the capital markets that may not be in the best interests of mutual members," Mr Fonteyne says.

Another issue is governance: mutuals' board members are elected from among their members, and are not always professional bankers. Some members of Crédit Agricole's board, for instance, are farmers by background. That should not disqualify them. But it gives them a lot to learn about capital markets. Following the losses at Calyon, Crédit Agricole in May replaced Mr Litzler with a long-term insider from the bank who has admitted that he does not know much about investment banking.

The only mutual which has not suffered a big loss either directly or indirectly is Crédit Mutuel. It learnt a lesson in 2005 after losing €320m on equity derivatives. In July Crédit Mutuel bought Citigroup's German consumer-credit business for €4.9 billion, and this month bought 67% of Cofidis, a distressed French consumer-lending business, for €1.9 billion. That worries some analysts. "It's not a good time to take on more exposure to consumer finance," says Nathalie Deliens of Société Générale.

But aside from their investment-banking activities, the mutuals have big retail-deposit bases, a cherished attribute in this crisis. They collectively sit on 57% of French retail deposits, according to Fitch, a rating agency, compared with just 8% for BNP Paribas and 7% for Société Générale. That also makes them a tempting target. BNP Paribas is said to be keen to get its hands on one of them to boost its presence in

French retail banking. For a listed bank to carry off a mutual would be unprecedented. A deal would require a new law to resolve the question of mutual status, and strong backing from the government. But if it were ever going to happen, now would be the likeliest time.

El Jefe

Nov 27th 2008
From The Economist print edition

Bloomberg



As accolades rain down on the Bank of Spain for its deft touch in the run-up to the credit crisis, Jaime Caruana, a former governor of the central bank, has been named as the next general manager of the Bank for International Settlements (BIS). He will take over the Basel-based central bankers' club in April, after leaving his current post at the IMF. Central bankers in many countries may be in disrepute, but the Bank of Spain has won praise for bolstering banks' capital through counter-cyclical loan-loss provisioning. The BIS also stands out for issuing clear warnings of global financial excess in recent years. Mr Caruana should fit in well.

Economics focus

The great wall of unemployed

Nov 27th 2008
From The Economist print edition

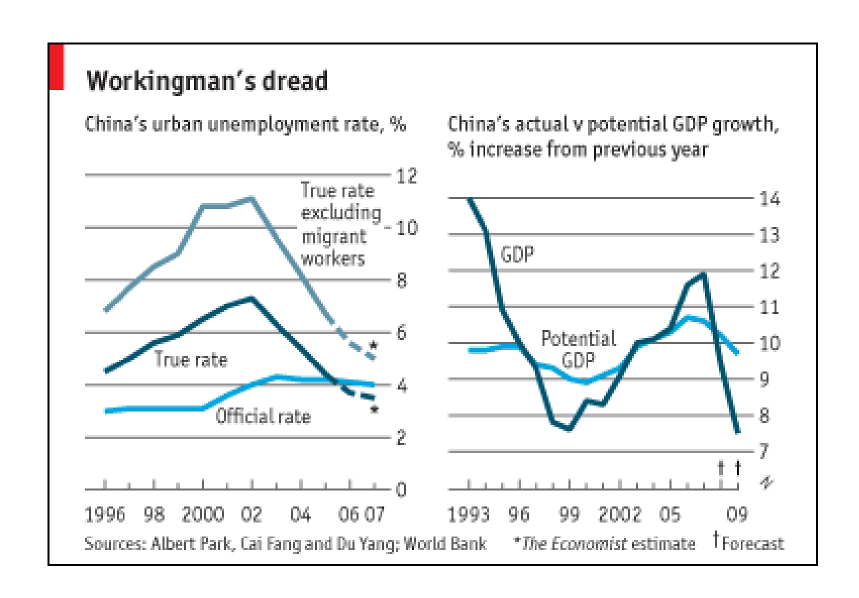
Joblessness in China is rising, prompting fears of social unrest. But how high is the true unemployment rate?

THE employment outlook is “grim” according to Yin Weimin, China’s minister of human resources and social security. So grim, in fact, that on November 26th the People’s Bank of China slashed rates by more than a percentage point—the most in 11 years—to boost growth. The slowing economy has led factories to cut jobs, and there are mounting fears that the swelling ranks of the unemployed might one day take to the streets and disrupt China’s economic miracle. To assess such risks one must consider how high unemployment might rise.

The snag is that both the level and trend of China’s official jobless figures are meaningless. Until the 1990s, the government more or less guaranteed full employment by providing every worker with an “iron rice bowl”—a job for life. But when soaring losses at state-owned firms forced the government to lay off about one-third of all state employees between 1996 and 2002, the official unemployment rate rose only slightly. Today it is 4% in urban areas, up from 3% in the mid-1990s.

But the official rate excludes workers laid off by state-owned firms. Thus at the start of this decade, when lay-offs peaked, it hugely understated true unemployment. Over time, as laid-off workers have found jobs or left the labour force, the distortion will have shrunk. Another flaw is that the official unemployment statistics cover only people who are registered as urban dwellers. An estimated 130m migrant workers have moved from the country to the cities, but there is no formal record that they live there, so they are ignored by the statisticians. After adjusting the official figures for these two factors, several studies earlier this decade concluded that the true unemployment rate was above 10%—and might be even as high as 20%.

If unemployment is already so high, it would not take much of an economic slowdown to push it to crisis levels. However, a more recent study suggests that the jobless rate has fallen a lot since the start of this decade. Albert Park, of the University of Oxford, and Cai Fang and Du Yang, of the Chinese Academy of Social Sciences, have analysed China’s 2000 census and 2005 mini-census (covering 1% of the population), which include migrant workers. The raw census data suggest that the total urban jobless rate fell from 8.1% in 2000 to 5.2% in 2005. But when the jobless figures are adjusted to an internationally comparable definition, the rate in 2005 was less than 4%.



As a crosscheck, the economists also used the 2005 Urban Labour Survey of five big cities. This confirmed that the urban unemployment rate, including migrant workers, had indeed fallen—from 7.3% in 2002 to

4.4% in 2005 (see chart). But the rate for migrant workers is lower than for permanent residents because they return home if they cannot find work. As the chart also shows, excluding migrants, the urban unemployment rate fell from 11.1% to 6.7%. And since 2005, unemployment has undoubtedly fallen further. Earlier this year, factory bosses complained that they could not find enough workers; and faster real-wage growth also suggested that demand for labour was outpacing supply. Thus before China’s economy started to sputter this summer, its jobless rate was probably only 3-4%. One important qualification to these numbers is that China’s labour-force participation rate—ie, those in work or seeking it—fell to 65% in 2005 from 69% in 2000. If discouraged workers have left the labour force because they could not find a job, then the unemployment rate may understate the hardship they face.

But the finding that unemployment has fallen sharply in China over the past five years makes sense. The right-hand chart, from the World Bank’s latest *China Quarterly Update*, shows GDP growth relative to its estimated potential growth rate if the economy operated at full capacity. From 2003 to 2007, actual growth ran ahead of potential, so unemployment should indeed have dropped. However, the bank expects China’s growth to fall below trend in 2008 and 2009, implying that unemployment will climb. The bank forecasts growth of only 7.5% next year, its slowest for almost 20 years and well below its estimated potential growth rate of around 9.5%. Jobs are already disappearing—especially in southern China, where thousands of small exporting firms have closed this year.

Time to rebalance

Chinese commentators are currently fixated upon whether the economy can continue to grow by at least 8% a year. That was the old rule of thumb for the growth needed to absorb new entrants into the labour market. But that 8% figure has little scientific basis. Over the past decade, the trend growth rate has increased as a result of heavy investment and faster improvements in productivity. Maybe that is why the World Bank reckons that China’s potential growth rate (ie, the rate needed to keep unemployment steady) is now about 9.5%.

For employment, the type of growth matters as much as its pace. China is creating fewer new jobs than it used to. In the 1980s, each 1% increase in GDP led to a 0.3% rise in employment. Over the past decade, 1% GDP growth has yielded, on average, only a 0.1% gain in jobs. Growth has become less job-intensive, so the economy needs to grow faster to hold down unemployment.

One reason for this is that the government has favoured capital-intensive industries, such as steel and machinery, rather than services which create more jobs. Louis Kuijs, the main author of the World Bank’s report, argues that China needs to shift the mix of its growth from industry, investment and exports to services and consumption. To adjust the structure of production requires a further strengthening of the yuan, raising the price of energy, scrapping distortions in the tax system which favour manufacturing, and removing various shackles on the services sector.

More labour-intensive growth would also boost incomes and consumption and so help to reduce China’s embarrassingly large trade surplus. But most important, by allowing more workers to enjoy the rewards of rapid growth, it could help to prevent future social unrest.

Economist.com SCIENCE & TECHNOLOGY

AIDS

The ideal and the good

Nov 27th 2008
From The Economist print edition

Deploying the drugs used to treat AIDS may be the way to limit its spread

Illustration by Peter Schrank



IT HAS become a cliché among doctors who deal with AIDS that the only way to stop the epidemic is to develop a vaccine against HIV, the virus that causes it. Unfortunately, there is no sign of such a thing becoming available soon. The best hope was withdrawn from trials just over a year ago amid fears that it might actually be making things worse. As a result, vaccine researchers have mostly gone back to the drawing board of basic research. Meanwhile, the virus marches on. Last year, according to UNAIDS, the international body charged with combating it, 2.7m people were infected, bringing the estimated total to 33m.

Reuben Granich and his colleagues at the World Health Organisation (WHO), though, have been exploring an alternative approach. Instead of a vaccine, they wonder, as they write in the *Lancet*, whether the job might be done with drugs.

In the spread of any contagious disease, each act of infection has two parties, one who already has the disease and one who does not. Vaccination works by treating the uninfected individual prophylactically. Since it is impossible to say in advance who might be exposed, that means vaccinating everybody. The alternative, as Dr Granich observes, is to treat the infected individual and thus stop him being infectious. For this to curb an epidemic would require an enormous public-health campaign of the sort used to promote vaccination. But that campaign would be of a different kind. It would have to identify all (or, at least, almost all) of those infected. It would then have to persuade them to undergo not a short, simple vaccination course, but rather a drug regime that would continue indefinitely.

Pills, not needles

The first question to ask of such an approach is, could it work in principle? It is this that Dr Granich and his colleagues have tried to answer. Using data from several African countries, they have constructed a computer model to test the idea. In their ideal world, everyone over the age of 15 would volunteer for testing once a year. If found to be infected, they would be put immediately onto a course of what are known as first-line antiretroviral drugs (ARVs). These are reasonably cheap, often generic, pharmaceuticals that, although they do not cure someone, do lower the level of the virus in his body to the extent that he suffers no symptoms. They also—and this is the point of the study—reduce the level enough to make him unlikely to pass the virus on. For the 3% or so of people per year for whom the first-

line ARVs do not work, more expensive second-line treatments would be used.

When Dr Granich crunched the numbers through the model, he concluded that if this scheme could be implemented, it would do the trick. The rate of new infections (now 20 per 1,000 people per year) would fall within ten years of full implementation to one per 1,000 per year. Within 50 years the prevalence of HIV would drop below 1%, compared with up to 30% at the moment in the worst-affected areas.

Whether such an approach could be made to work in practice—and if it could, whether it should—are two other questions. The existing plan for combating HIV centres on saving the lives of those already infected. The intention is to make ARVs available to everyone who needs them, in rich and poor countries alike, by buying the drugs cheaply and building the infrastructure of doctors, nurses and clinics to prescribe and provide them. “Needs”, however, is defined as “at risk of developing symptoms”. People with HIV often remain asymptomatic for years, and conventional wisdom is that treating such people brings little clinical benefit while exposing them to unpleasant side effects such as nausea, vomiting and diarrhoea.

Even vaccination bothers some medical ethicists because, although it does protect the vaccinated individual, governments promote it in order to create “herd immunity”—from which the unvaccinated will also benefit. Treating asymptomatic carriers of HIV causes greater qualms if it brings no benefit to the people actually taking the medicine. However, Kevin De Cock, one of Dr Granich’s colleagues, points out that the latest research suggests such people are not as asymptomatic as had once been thought. They may suffer from illnesses such as heart, kidney and liver diseases and cancers that are not classical symptoms of AIDS. Indeed, a recent study suggested that deferring treatment until classical symptoms appear increases the chance of someone dying by 70%.

If that result is confirmed, it would change the ethics completely. It would also make it easier to persuade people to come in once a year for testing at their local clinic, even if they felt well. And it would create pressure for the current policy to be reviewed anyway, so that something like the scheme Dr Granich and his colleagues have been investigating might end up happening by default.

If the scheme were implemented (and the WHO is at pains to point out that this paper in no way indicates a change of policy), it would be more costly to begin with than the existing plan of universal access. However, that would change over the years, as the caseload fell. This seems, therefore, to be an approach worth exploring. AIDS doctors are not so spoilt for options that they can afford to ignore new ones. Employing the logic of vaccination using proven drugs may be an idea whose time has come.

Pharmaceuticals

Absence of evidence

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From The Economist print edition

Do drug firms suppress unfavourable information about new products?

RICHARD FEYNMAN, a Nobel-prize-winning physicist, declared in a speech in 1974 that science requires "a kind of utter honesty". He insisted that researchers must publicise all the outcomes of their work, and "not just the information that leads to judgment in one particular direction or another". To judge by the mounting evidence of publication bias involving studies on new drugs, his words have not yet reached the pharmaceuticals industry.

A study published this week in *PLoS Medicine*, an online journal, confirms what many have suspected and what previous studies have hinted at: drug companies try to spin the results of clinical trials. If this were done merely in marketing materials, it might be tolerable. What Lisa Bero of the University of California, San Francisco, and her colleagues found, however, was troubling evidence of suppression and manipulation of data in studies published in (or often withheld from) peer-reviewed medical journals.

To see if firms massaged data from trials of new drugs, Dr Bero and her team compared the information that companies share with America's Food and Drug Administration (FDA) about those drugs with what they eventually publish in medical journals. By law, submissions to the FDA must be comprehensive, whereas decisions on whether and how to publish those same data later in journals are governed by self-interest, scientific convention and peer review.

In theory, there should be no difference between what the regulators are told about a new drug's strengths and weaknesses and what doctors and other researchers read in journals. But Dr Bero's study found a yawning gap between the two. By looking at all the new-drug applications approved by the FDA in 2001 and 2002, the researchers got hold of a comprehensive set of data. They checked whether, five years later, details on all of those trials had made it into print intact.

The results are distressing. Only three-quarters of the original trials were ever published, and it turned out that those with positive outcomes were nearly five times as likely to be published as those that were negative. Earlier investigations have shown that the explanation is not editorial bias: well-designed studies in which drugs fail have as good a chance of being published in leading journals as those in which drugs succeed.

In the years studied by Dr Bero, 155 primary outcomes appeared in both regulatory filings and in the medical literature. However, the FDA knew about 41 others that never made it into a journal. On top of that, 17 outcomes appeared in publications without having first been discussed in regulatory filings. Fifteen of these 17 made the drugs in question look better. And even when published studies had been filed with the FDA, on several occasions the published conclusions differed from those reported to the FDA in ways that favoured the new drugs.

Industry experts insist there are benign reasons for some of these discrepancies. For example, in the hope of making a name for themselves, overworked researchers may choose to publish successful studies rather than push to get a failed or problematic investigation into print. Sometimes the trials as submitted to the FDA are flawed, so researchers try to fix them before getting them published (though that would not explain why so many of the "fixes" seem to make the drug in question look better).

Dr Bero is unimpressed by such arguments. She points out that many patients enter drug trials believing the results will be published, so that researchers can develop new therapies. Others complain that misleading presentations in journals may lead ill-informed doctors to favour new drugs over cheaper, older ones even if they work no better or have undesirable (but unadvertised) side effects.

Such grouses have resulted in a few changes. The main federal sponsor of biomedical research in America, the National Institutes of Health (NIH), runs a website, clinicaltrials.gov, on which all drugs trials must be registered in addition to being reported to the FDA. And since September the NIH and FDA have

published brief summaries of trial results. But critics would like to see more action. An-Wen Chan of the Mayo Clinic, a large medical-research centre in Minnesota, wants the public to have access to the full details of the protocols used to study all new drugs. Dr Bero argues that it is unethical not to publish the full results of medical trials. Feynman would surely have agreed.

Aerodynamics

Blowin' in the wind

Nov 27th 2008
From The Economist print edition

Flapping flags may shed light on how fish school and birds flock

OFTEN it pays not to be leader of the pack—just ask a racing cyclist or a Formula One driver. Conserving energy by following the leader, a trick known as slipstreaming, can give a rider or driver that extra bit of juice to pull ahead at the very last moment. In the natural world, however, bodies are more likely to be flexible, like a fish's, rather than rigid, like a car's. In these systems, as a recent paper in *Physical Review Letters* reports, it is the leader that enjoys a significant dynamic advantage over the followers.

Jun Zhang of New York University came to this conclusion obliquely, by examining one of life's burning questions: why is it that flags flutter in a breeze? Flags are good analogues of birds and fish because all three change their shape as they move through a fluid. In 2000 Dr Zhang did some experiments to study the motion of thin silk filaments (standing in for flags) in flowing films of liquid dishwashing soap (standing in for the breeze).

As the soap film "blew" past a flag it formed streams and eddies. Dr Zhang was able to observe these by illuminating it. Light bouncing within the film between its surfaces creates an interference pattern (this is why soap bubbles appear coloured). Streams and eddies in such a film alter its thickness, and thus the details of this interference pattern, allowing the pattern of irregularities induced by the flag to be captured on camera.

These initial experiments revealed that fluttering is an intrinsic feature of the motion of a flag. Make a flag long enough, and it will flutter no matter how steady the breeze. This is because the shape of the flag changes. Any small instability in shape causes changes in the flow of fluid, which alters the shape further. The whole process thus amplifies the fluttering.

Now, in collaboration with Leif Ristroph of Cornell University, Dr Zhang has used the same technique to look at what happens when there are several objects in the moving fluid—a series of flags outside a government office, for example, or a line of fish in a school.

In this case, the researchers were surprised to find that the familiar physics of slipstreaming were inverted. If one flag has a second downwind of it, that second breaks up the wake of the leader. This stops that wake being a single, coherent back-and-forth wave. As a result, the leading flag flies straighter. In a line of many flags, moreover, most experience this reduced drag in turn, making the whole group more aero- (or hydro-) dynamic.

Inverted slipstreaming of this sort could have some counterintuitive effects. A fish frantically trying to escape from a predator might get the advantage of reduced drag. As the team put it in their paper, "it is better to be chased than to chase." However, fish and birds actively change their shape when they swim and fly, whereas flags flutter passively in the breeze. Whether this makes a difference is not yet clear. The researchers therefore plan follow-up tests with aquarium fish to see if they, too, experience inverted slipstreaming. If they do, then there may, eventually, be engineering applications. Whether wobbly bikes and flexible racing cars are among them remains to be seen.

Conservation

Tuna in trouble

Nov 27th 2008
From The Economist print edition

Anger that the catch will still be too big

ACCORDING to conservationists it is a disaster for the bluefin tuna, but as far as the European Commission is concerned it is a landmark decision to try to conserve their stocks. These are the opposing views of the outcome of a meeting this week in Morocco to set the allowable annual catch of the species, the population of which has tumbled because of overfishing, mainly by European fleets.

The organisation responsible for looking after tuna in the north-east Atlantic and the Mediterranean Sea, the International Commission for the Conservation of Atlantic Tunas (ICCAT), agreed to reduce the total allowable catch of bluefin in these areas from 28,500 this year to 22,000 tonnes next and to 19,950 tonnes in 2010, to give a total cut over two years of 30%. But this was considerably short of what many scientists—including some experts appointed by ICCAT—say is necessary. They wanted the catch to be limited to 15,000 tonnes. Some countries, including Spain, had wanted the fishery suspended altogether.

Oceana, an environmental group, said that with ICCAT ignoring its own scientific advice the future of the bluefin is now threatened, not least because in the past fishermen have taken around twice the permitted catch. The World Wide Fund for Nature, which has also been campaigning for a substantial cut in the catch, is now seeking an international trading ban on bluefin. It is urging a wider consumer boycott, too. Some restaurants have already banned the fish.

The European Commission, however, says it is satisfied with the consensus that was reached between the members of the group because the cut in the catch will be reinforced by a reduction in the fishing season and other methods of conservation. Enforcement will also be improved. This, says Joe Borg, the European commissioner for maritime affairs and fisheries, will mean more policing of the sale of tuna and the closure of loopholes in the regulations.

None of that is likely to satisfy the conservationists. Computer modelling of the species's population earlier this year, by the Technical University of Denmark, concluded that, even if fishing for bluefin were banned, stocks in the north-east Atlantic and Mediterranean were so badly damaged that they would probably collapse anyway. Conservationists may now take another approach and try to persuade CITES, the international convention that regulates trade in endangered species, to put bluefin on its list of those threatened with extinction.

Clarification: Treatment of drug addiction

Nov 27th 2008
From The Economist print edition

An article in the issue dated October 18th ("Treatment on a plate") described a nutritional approach to the treatment of drug addiction. Part of the article was reported from a conference, one of whose organisers is a nutritionist with a commercial interest in the relationship between diet and brain function. It has been drawn to our attention that the author of the article is also the co-author of a book with this organiser. Had we known this at the time, we would not have commissioned the piece from him. It has also been suggested that some of the studies alluded to were too small to support the conclusions drawn from them. The article made clear that these studies (which had been published independently of the conference) were preliminary and that further investigation would be needed to substantiate this approach. However, it may not have been clear that the experiments were conducted using nutrients found in the foodstuffs mentioned, rather than using the foods themselves.

Gilbert Kaplan

Desperately seeking Mahler

Nov 27th 2008
From The Economist print edition

He conducts just one symphony, Mahler's second. But Gilbert Kaplan has radically changed the way Mahler is perceived, both by audiences and other musicians

Tanja Niemann



ONE April Saturday in 1965, an economist at the American Stock Exchange was taken by a friend to an orchestral rehearsal at Carnegie Hall. He watched impassively as Leopold Stokowski, the aged Hollywood maestro who conducted "Fantasia", stop-started Gustav Mahler's Symphony No.2 in C minor all afternoon. The economist thought little of it until later that night, when, sleeplessly, he tossed and turned, haunted by the music he had heard. Next morning he bought a ticket and at the concert "just found myself sobbing, absolutely hysterical".

The young man was about to launch a publishing business and, with it, to define an occupation. With $100,000 borrowed from Gerald Bronfman, a whisky magnate, and $50,000 from banks, friends and his own savings, Gilbert Kaplan, 24 years old, founded *Institutional Investor*, a monthly magazine that brought together bankers, analysts and money managers. It quickly became an essential means of communication for financiers, attracting 150,000 subscribers in 140 countries. Before the 1960s were over Mr Kaplan was a millionaire and on first-name terms with finance ministers and international bankers.

But Mahler's symphony would not let him rest. Over the next few years he attended every performance within reach, met his future wife in the adjacent seat at London's Royal Festival Hall and, as the obsession intensified, took 18 months off work to study the score and discuss it with such leading interpreters as Leonard Bernstein, Sir Georg Solti and Leonard Slatkin. In September 1982, after an International Monetary Fund summit, he put his reputation on the line by conducting the American Symphony Orchestra in a private performance for financiers and politicians at the Lincoln Centre. A former British prime minister, Sir Edward Heath, himself a spare-time conductor, called it "a very remarkable feat", but that was, if anything, an understatement.

Mahler's second symphony, known as the "Resurrection" for its rousing choral climax and theological theme, is one of the trickiest works in the repertory, a 90- minute epic involving a huge orchestra, chorus, two vocal soloists and an invisible offstage group of brass and percussion that seldom come in on cue. Discussing the purpose of life on earth, its unwieldiness regularly defeats the best efforts of famous maestros. For a rank amateur to accomplish a performance without breaking down in the vast finale was

tantamount to a musical revolution. Privately Mr Kaplan now admits that if the musicians had failed to respond to his beat or the music fell apart (as it sometimes does in the best of hands), his fallback plan was to turn around to the audience and announce: “Ladies and gentlemen, dinner is served.”

His feat, discreet though it was, reverberated throughout the music world. Over the following years Mr Kaplan was invited to conduct flagship ensembles at La Scala in Milan, in Munich and Vienna, to open the prestigious Salzburg festival and to give the work its Chinese premiere in Beijing. His recording, made in Cardiff in 1985, has outsold Bernstein, Pierre Boulez, Claudio Abbado and all other contenders. On December 8th his odyssey reaches an emotional apotheosis when he conducts the work with the New York Philharmonic at the Lincoln Centre’s Avery Fisher Hall 100 years to the night after the composer, with the same orchestra, gave the piece its American premiere.

Pleasing as this symmetry will be to the now-retired publisher, the results of his presumption are far-reaching. Mr Kaplan is acknowledged as the leading technical authority on Mahler’s second symphony, consulted by many professional maestros on matters of detail. He was the first to import television screens and cameras to communicate with the offstage band, a device now in common use.

He owns the composer’s manuscript, acquiring it in 1984 from a Dutch foundation, publishing it in facsimile and obliging Vienna’s Universal Edition to print a corrected new score which is faithful to Mahler’s final amendments. The Vienna Philharmonic gave its first note-perfect performance under Mr Kaplan’s baton and he experienced his deepest satisfaction when the horn section, struggling in a recording session to accommodate the changes, played one passage 11 times in their earnestness to get it right.

Mr Kaplan’s involvement with the second symphony has made it probably the most talked-about of Mahler’s works, diverting public attention away from the morbidity of his last great pieces. The long-standing image of Mahler as a composer of doom has been set aside, in part through Mr Kaplan’s advocacy.

That an unskilled dreamer could teach professionals how to bring off a masterpiece is a fantasy that many share but few presume to achieve. Mr Kaplan, after his first performance, said: “I had a feeling that people in the audience were urging me to fulfil my dream. They were up with me on the podium that night, playing baseball for the Yankees, writing the book they never wrote or getting the girl they never got.”

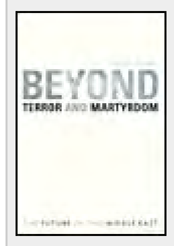
His has been a triumph of ambition over intractable matter, a fulfilment of Mahler’s faith in Arthur Schopenhauer’s idea that the human will can overcome any force on earth. Or, in more contemporary Obamist rhetoric, Yes We Can.

Gilles Kepel

Beyond terror and martyrdom

Nov 27th 2008
From The Economist print edition

Beyond Terror and Martyrdom: The Future of the Middle East
By Gilles Kepel



Belknap Press; 328 pages; $27.95 and £18.95

Buy it at
Amazon.com
Amazon.co.uk

GEORGE BUSH will leave office in January at the end of a presidency that was looking ignominious even before America's recent economic train wreck. Nothing contributed more to Mr Bush's failure than al-Qaeda's audacious multiple terrorist attacks on the American homeland on September 11th 2001. This book, from one of France's shrewdest interpreters of the Muslim world, provides a highly readable end-of-term conspectus of the subsequent violent encounter between America and the jihadists. It also offers an intriguing argument.

In Gilles Kepel's telling, it is not only Mr Bush whose strategy failed after September 11th. Osama bin Laden's strategy failed too. The Bush administration's "global war on terror" encompassed not only the invasions of Afghanistan and Iraq but also a project to spread democracy to the Arabs and remake the dysfunctional Middle East in America's image. It was, in Mr Kepel's phrase, "a vision of global rectification through violent means". That was precisely al-Qaeda's project as well. Mr bin Laden did not intend only to inflict pain on America and force its armies out of the Middle East. Martyrdom was also supposed to lead the Muslim masses to identify with al-Qaeda, to hasten a general uprising against "apostate" governments like Saudi Arabia's, to precipitate the establishment of an Islamic state and destroy Israel.

In the event, as Mr Kepel demonstrates, both of these grand, transformative narratives "crashed against a wall of reality within the Muslim world". Instead of throttling jihadism, the American occupation of Iraq recruited an army of new martyrs to the cause. But far from rallying the Muslim world at large to its banner, the murderous *jihad* in Iraq—and al-Qaeda's killing of many Muslims in other Muslim lands—ended up repelling the very audience this epic struggle was intended to attract. Indeed, to the extent that radical Islam grew stronger during this encounter, it was not the Sunni zealots of al-Qaeda who benefited but their rival pretenders to leadership of the Muslim world: notably the Shia leaders of Iran and, after the 33-day war with Israel in 2006, Iran's Hizbullah co-religionists in Lebanon.

Although Mr Kepel is by no means the first person to mark this ironic and reciprocal tragedy of unintended consequences, he has a rare ability to tell a tale in a way that is easy to follow and yet does justice to the granular complexities of the Muslim world. And his argument has a third leg, one that is more original, more optimistic but also more controversial. This holds that Europe—which both the jihadists and some of Europe's American detractors (remember "Eurabia") see as the West's softest underbelly—is in fact the one place where experiments in cultural integration are flourishing and promise to create "a unique deterrent to the logic of terrorism".

This conclusion may surprise people in Europe with vivid memories of the suicide-bombing by disaffected British Muslims of London's underground, the violent protests that greeted the Danish cartoons of Muhammad, or the grisly murder in the Netherlands of Theo van Gogh, a film-maker who had dared to criticise Islam. Mr Kepel concludes that Britain and the Netherlands have taken multiculturalism too far, neglecting the need to establish a common national identity that Muslims could share with the native population—something the headscarf-banning French, by contrast, have absolutely insisted on.

Hold on. Didn't young Muslims set the Parisian *banlieues* on fire in the autumn of 2005? They did; but the author makes a plucky case, buttressed by some robust polling data, that the riots of Paris, though driven by Muslim anger at neglect and marginalisation, had nothing to do with terror or *jihad*. On the contrary, by expressing their frustration, they "inadvertently pointed out the promise of a society that rejects ideologies of separatism and embraces the ideology of inclusion, however often it fails to realise that dream fully." One of Mr Kepel's big ideas is that there is the beginning here of an understanding on values, which could be consolidated and spread by means of the economic integration of Europe and the Middle East. This part of his thesis may seem more wishful than professorial, but here's hoping.

Beyond Terror and Martyrdom: The Future of the Middle East.
By Gilles Kepel.
Belknap Press; 328 pages; $27.95 and £18.95

Playing the French horn

Blowhard

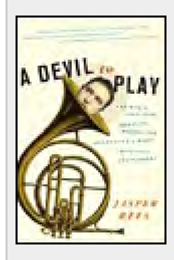
Nov 27th 2008
From The Economist print edition

Dillon Bryden



Horn of plenty

A Devil To Play: One Man's Year-Long Quest to Master the Orchestra's Most Difficult Instrument
By Jasper Rees



Harper; 324 pages; $23.99. Published in Britain as "I Found My Horn"

ABOUT to turn 40 and bruised by the end of his marriage, Jasper Rees, a British journalist, climbed up to his attic and found a misshapen case containing his childhood nemesis: a French horn. Quite where the insane idea of playing a concerto before the annual gathering of most of the greatest living horn players came from is hard to tell, but the result is a marvellous memoir of a year's obsession that should be read by anyone gripped by illogical compulsion.

What sets the horn apart? First and foremost, it is the sound—"a call of nature, an atavistic summons"—directly descended from the clamour that brought down the walls of Jericho. Then there is the astonishing difficulty of consistently hitting the right notes, let alone making music.

Mr Rees, whose book came out in Britain in January and is now being published in America (and turned into a stage show in London), introduces the greatest players. First comes Giovanni Punto, an 18th-century Bohemian who became the subject of an aristocratic *fatwa* requiring the removal of his front teeth when he had the temerity to leave his boss Count Joseph von Thun's employment without permission. Then there was Mozart's friend Joseph Leutgeb (to whom Mozart dedicated his horn concerto, K417, calling him "ass, ox and simpleton"). There are three generations of Brains, a British horn-playing dynasty; Helen Kotas, the first woman to be principal horn player for a major American orchestra; Herman Baumann and the Anglo-Australian, Barry Tuckwell.

What they all share is an absolute certainty that the horn is an instrument like no other. Richard Strauss called for "lots of horns, which are always a yardstick for heroism". Sir Simon Rattle puts it differently: "You never eyeball a horn player. You just don't. They're stuntmen. You don't eyeball stuntmen when they're about to dice with death."

A Devil To Play: One Man's Year-Long Quest to Master the Orchestra's Most Difficult Instrument.
By Jasper Rees.
Harper; 324 pages; $23.99. Published in Britain as "I Found My Horn"; Weidenfeld and Nicolson; £14.99
Weidenfeld & Nicolson

Hugo Young

Up close and personal

Nov 27th 2008
From The Economist print edition

The Hugo Young Papers: Thirty Years of British Politics—Off the Record
Edited by Ion Trewin

Allen Lane; 834 pages; £30

Buy it at
Amazon.co.uk

IT IS hard to turn 800-plus pages of notes on such esoteric subjects as Jim Callaghan's dithering over an election date, or Gordon Brown's five tests for joining the euro, into a riveting read. That Hugo Young's accumulated notebooks amount to just that is due to two things. The first is that Young, an influential political columnist on the *Sunday Times* and then the *Guardian* who died in 2003, had incredibly good contacts and cultivated them relentlessly for upwards of 30 years. The second is that he meticulously summarised these off-the-record conversations as soon as he got to a desk. The result is a blow-by-blow account of what those who made recent British history were thinking as they did so, with no subsequent airbrushing out of the misjudgments of the moment.

For the most part, Young draws on a wide assortment of politicians, civil servants, union officials, diplomats and others to piece together the subtext of British politics. Young was more able than most to see the importance of Margaret Thatcher, although he did not share her politics. He was at his best in distilling complicated, fluid stories, such as the secession from the Labour Party of the Gang of Four in 1981 to set up the Social Democrats, for example, or the debate over whether the New Labour government should hold a referendum on the euro (its failure to do so was a grave disappointment to the strongly pro-European Young). Alan Rusbridger, Young's editor at the *Guardian*, describes his columns as "like icebergs: readers saw a sunlit tip of crystal argument. They may have guessed but they never truly saw what lay beneath."

The conversations were originally off the record, and not everyone consented to lift that ban. Among the missing must surely be notes of discussions with Tony Blair, who may prefer to present the world with his own version of events before long. But among the unexpected treats are Young's own spontaneous assessments. Norman Lamont, John Major's chancellor of the exchequer, is "still a fat little man, but a hard fat man rather than a soft fat man". Cherie Blair, with whom Young had his last recorded conversation in July 2003, had "very red lips".

On whom did Young rely? Douglas Hurd, foreign secretary in the Major government, and Chris Patten, the last governor of Hong Kong, were among his stalwart sources. He had time for Ken Clarke, Conservative chancellor of the exchequer, among other things, and for Robin Cook, Mr Blair's first foreign secretary, who resigned over the invasion of Iraq. He struggled with two characters in particular.

Michael Portillo was one. Young seems instinctively to have disliked the Tory pretender, who was defence secretary in the Major cabinet and tipped by many to become head of the Tory party. "It's a long time since I've met a more coldly dedicated politician," Young wrote in 1994. Yet he came back again and again for Mr Portillo's "interesting" views.

The other was Mr Brown, who shared with Mr Portillo ability, ambition, arrogance and a total dedication to politics. In his first mention of the man who was to become prime minister, Young describes him in 1990 as "pleasant, serious and uninformative". Later Young was struck by the "unreflective frenzy of his discourse". But as Mr Brown hammered away at the ideas underpinning New Labour, from fiscal restraint (how ironic that sounds today) to policies against long-term unemployment, Young came to see him as "truly an *homme sérieux*" and finally described him as "a very committed public servant in the best and uncynical sense". As indeed was Hugo Young, journalist.

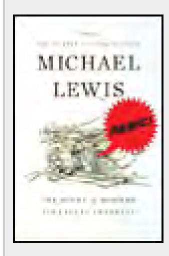
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Allen Lane; 834 pages; £30

Michael Lewis

Modern financial insanity

Nov 27th 2008
From The Economist print edition

Panic: The Story of Modern Financial Insanity
Edited by Michael Lewis



Norton; 352 pages; $27.95. Penguin; £9.99

Buy it at
Amazon.com
Amazon.co.uk

BOOKS on finance are all too often dull and ridden with jargon. But an honourable exception can be made for studies of financial panics and corporate failures. Human folly never seems quite so foolish as when it is losing tons of money.

Michael Lewis, the author of "Liar's Poker", is the ideal writer to dissect the behaviour that led to the current credit crunch. The bad news is that he is only the editor of this collection of articles (including a couple from *The Economist*). The good news is that he has not been constrained by false modesty and has chosen six of his own pieces for this book. As one would expect, they are witty, incisive and original.

Mr Lewis also contributes an introduction to each of the sections dealing with the four main panics of the last 21 years; the stock market crash of 1987, the Asian crisis of 1997-98, the bursting of the dotcom bubble after 2000 and the current housing and banking bust. It is worth remembering, as we contemplate the gloomy economic future, how each of the previous three crises was greeted with apocalyptic headlines. "How many times does the end of the world as we know it need to arrive before we realise that it's not the end of the world as we know it?" Mr Lewis writes, in perhaps the most telling sentence of the book.

The compiler's contributions apart, the selection is a mixed bag. The aim was to give readers a flavour of sentiment before the bubbles burst, as well as analysis of the aftermath. But the result is a surfeit of rather flat news stories and the book only really comes to life with the last two sections, perhaps because the follies of dotcom valuations and subprime loans seem so fresh in the memory. It is hard not to feel nostalgic for the days when Computer.com (a website for novice users of technology) was able to spend 60% of its seed funding on a 90-second ad during the 2000 Superbowl. Or when the shares of Books-A-Million, a retailer, rose tenfold within three days on the back of an upgrade to its existing website. In an echo of the South Sea Bubble, there even were companies sold as an "undertaking of great advantage but no one to know what it is"—so-called internet incubators that planned to invest in other unnamed businesses.

Then there is the housing boom where in one example a couple secured loans worth $1.5m on a house bought (with no money down) for $1.16m. They then extracted $333,000 to spend on consumer goods and lived in a nice home for three years before walking away. Some telling articles from the *New York Times* (including one from Paul Krugman, a Nobel laureate in economics) analyse the madness.

Does the book have a recurring theme? Perhaps, to misquote Noel Coward, it is the extraordinary potency of cheap money. Commentators were alive to the dangers of excessive lending in the housing market, as an excellent *New Yorker* piece from John Cassidy (dating back to 2002), makes clear. But few can resist the temptation of buying a rising asset with a cut-price loan. Give it a decade or so and Mr Lewis will have the chance to update his volume.

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Edited by Michael Lewis.
Norton; 352 pages; $27.95. Penguin; £9.99

Smart philanthropy

Lessons in how to give

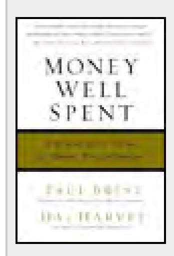
Nov 27th 2008
From The Economist print edition

DIRE predictions that the financial crisis will result in a calamitous decline in philanthropy are probably exaggerated. In America, still the most generous of nations despite the financial-markets crisis, total giving has risen every year since before the Great Depression, except in 1987 when the stock market crashed. But even if the pessimists are right, it only reinforces the need for every philanthropic dollar to achieve the greatest possible impact.

How to do this is the theme of “Money Well Spent”. Written by Paul Brest, of the William and Flora Hewlett Foundation, and his former colleague, Hal Harvey, now of the ClimateWorks Foundation, the book dispenses practical advice to aspiring philanthropists and provides examples of the ways they can influence the world—from education to climate change to the arts.

The authors do not avoid controversy. Those who think philanthropy should stay out of politics will not like the chapter on “influencing individuals, policy-makers and businesses”. The growing “mission-related investment” movement, which urges foundations to invest in ways that support the thrust of their giving, will not like their conclusion that “although screening out investments in companies whose practices you abhor may serve institutional values, the practice is largely ineffective in achieving social impact.”

Money Well Spent: A Strategic Plan for Smart Philanthropy
By Paul Brest and Hal Harvey



Bloomberg Press; 304 pages; $27.95 and £13.99

Buy it at
Amazon.com
Amazon.co.uk

Messrs Brest and Harvey seem most excited about philanthropy when it plays the role of “risk capital” for solving society’s problems. With risk comes the hope of disproportionate impact, but also some probability of failure. They argue that philanthropy needs to celebrate its failures as much as its successes, so society can learn from them and thus ensure the money was not wasted.

At the Hewlett Foundation, Mr Brest has even introduced an annual competition among his staff to find “the worst grant from which you learned the most”. He says this is now fiercely contested.

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Bloomberg Press; 304 pages; $27.95 and £13.99

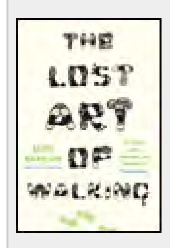
Walking

More than gadding about

Nov 27th 2008
From The Economist print edition

FROM the Wandering Jew to the Lambeth Walk, via the Sony Walkman and much else besides, it is hard to find any literary, cultural or historical reference to walking that is not included in Geoff Nicholson's bewitchingly informative treatise.

The Lost Art of Walking: The History, Science, Philosophy, and Literature of Pedestrianism
By Geoff Nicholson



Riverhead; 288 pages; $24.95

Buy it at
Amazon.com
Amazon.co.uk

Illustration by Daniel Pudles

Lovingly collected factoids leap off the page. British troops in the first world war were given "forced march tablets" consisting of cocaine. It takes a brisk 35 miles (56km) to burn off a pound (0.45kg) of body fat. Some of the commonest synonyms for walk in the English language (such as trudge, stroll and saunter) have no clear etymological roots. The best term associated with walking is not English at all: the French *flâner*, he writes, is "a truly wonderful word…it can mean to stroll, but it can also mean the act of simply hanging around."

This book is no mere miscellany, but the story of a man's love affair with the oldest means of locomotion: one foot in front of the other. Walking, he says, is like sex: "basic, simple, repetitive activities…capable of great sophistication and elaboration. They can be completely banal and meaningless, and yet they can also involve great passions and adventures. Both can lead you into strange and unknown territories: a walk on the wild side."

Mr Nicholson lives in Los Angeles where walking is regarded as eccentric and can get you arrested. But as he explains, that is part of the fun. Readers who don't know the car-choked geography of that sprawling city may prefer the chapters on New York and London. He tramps the full length of London's ghastly Oxford Street six times in a day, and makes it sound enjoyable and interesting.

Part of the fun is the way he condenses the work of others who have approached the subject pompously or sententiously. He quotes a literary theorist, Michel de Certeau, who writes that walking "is a process of appropriation of the topographical system…a special acting-out of the place…it implies relations among differentiated positions". Mr Nicholson summarises this as: "writing is one way of making our world our own, and walking is another."

The wafflier the piffle, the more sharply Mr Nicholson wields his skewer. His deadpan treatment of "psychogeography" (imagine modern literary criticism applied to the layout of car parks) is howlingly funny. So are his demolitions of the sub-Thoreau ramblings of "New Agers". Which bit of nature have they been walking in: "Frozen wastes? Disease-ridden jungle? Malarial swamp? Or just the local park?"

The best thing about walking is that you are your own boss: start and halt, look at everything or nothing, think about a lot or a little. And nobody (except perhaps a suspicious LA cop) will stop you.

The Lost Art of Walking: The History, Science, Philosophy, and Literature of Pedestrianism.
By Geoff Nicholson.
Riverhead; 288 pages; $24.95

Boris Fyodorov

Nov 27th 2008
From The Economist print edition

Boris Fyodorov, a Russian economic reformer, died on November 20th, aged 50





MOST of Russia's super-rich spend their summer holidays on yachts in the sunny Mediterranean. Boris Fyodorov preferred visiting English country churches, the older, the better. The buildings, and especially the gravestones, fascinated him. He saw in them symbols of an historical continuity that Russia had lost under communism. Born in poverty as a factory caretaker's son, he delighted in making discoveries among his aristocratic roots: trinkets unearthed at his family's ruined estate, a (Polish) coat of arms. His *dacha* outside Moscow was notable not for pet wolves or other fashionable extravagances, but for his valiant attempts to create a weedless, stripy English lawn in a hostile climate. He flew a Russian flag there too, scandalising the neighbours, who insisted he needed a permit.

Visitors to his office sometimes wished the chairs had seat belts. Conversation would ricochet from Russia's recent economic history to the tragedy of the aborted reforms brought in by his hero, Pyotr Stolypin, one of Tsar Nicholas II's prime ministers. It would touch on the lamentable failure of the Kremlin under Vladimir Putin to promote proper corporate behaviour in the boardrooms of Russia's big companies, bounce to the hypocrisy of Western bankers who failed to pay their taxes, and come to rest with a robust inquiry into the virtues of cylinder mowers compared with the rotary kind.

The chat would be in muscular, fluent English. Mr Fyodorov's job in the declining years of the Soviet Union had included monitoring the world economy by reading the *Financial Times*. This had left him at ease with the jargon of the new age, and also well placed to be finance minister of Russia (still just a part of the Soviet Union) as the planned economy entered its death throes. He briefly represented Russia (after it had become an independent country) at the World Bank in Washington, and then spent a year as deputy prime minister and, for a short while, as finance minister too.

Practitioner, not politician

It was not a great success. Like several other reformers of the time, he had a firmer grasp of economics than of politics: he was too unworldly, too impatient and perhaps too cerebral for the murky world of Russian government. Even so, he helped to create, almost from scratch, a Western-style financial system

with capital markets, payments systems and a semi-independent central bank. Despite the wholesale theft-by-privatisation that followed, these achievements look more impressive now than they did in the chaos of the time.

Once out of office, Mr Fyodorov published, among other books, a useful encyclopedia of financial terms. Some were recovered from pre-revolutionary Russian, others were neologisms. As a Russian patriot, however, he detested the practice of simply adapting an English word. *Ofshorky* (offshore accounts) was a pet hate, particularly because of its association with tax evasion. As head of the tax service, briefly, in 1998, he tried to decriminalise tax collecting, already well on its way to becoming an extortion racket, and also to broaden its reach to the rich and powerful—many of them all too familiar with *ofshorky*. Bravely, he set his inspectors on such prominent figures as Vladimir Zhirinovsky, a clownish extremist with connections to Russia's rulers. He also tried to scare expatriate bankers into paying taxes on their salaries (amounting to $5 billion a year, he thought) and their local landlords into declaring the rents extracted from such foreigners ($1 billion).

Mr Fyodorov had by this time also gone into business, founding United Financial Group, an investment bank, with an American friend in 1994. Yet neither wealth, connections, nor the flashing blue light on his black limousine (a hallmark of status in Russia) made Mr Fyodorov quite typical of the elite that moved so smoothly from burying communism to embracing capitalism red in tooth and claw. On the contrary, he despised such people for their lack of scruple. Without a moral basis, he said, capitalism would just become the means by which the powerful would concentrate their wealth.

That was prescient. Mr Fyodorov's last great cause before dropping out of public life was to try to make big Russian companies treat their shareholders properly, rather than serving the interests of bureaucrats and cronies. As a director of Gazprom, Russia's vast gas monopoly, he attacked the practice of issuing two classes of shares, one for domestic investors and one for foreigners. That depressed the true value of the company. His own bank made tidy profits from intricate schemes through which foreigners could act as though they were Russian shareholders. Eventually, once its two-tier share system was abolished, Gazprom became one of the world's most valuable energy companies.

But it remained one of the worst run, much to Mr Fyodorov's disappointment. For another of his aims was to strip away the intermediary firms that loot cashflow and assets from large Russian companies with the connivance of the management. One of his targets at Gazprom was closed down as Mr Putin and his friends gained control, but others soon took its place. Mr Fyodorov used to lament the fact that even he could not find the right phrase in Russian for "corporate governance".

Overview

Nov 27th 2008
From The Economist print edition

There were more signs of economic weakness in **America** in October. Orders for durable goods fell by 6.2%, the biggest monthly drop in two years. Consumer spending fell by 1% despite a modest rise in personal income. And sales of new single-family homes fell by 5.3% to an annual pace of 433,000, the lowest since January 1991. Interest rates on mortgages fell this week after the announcement that the Federal Reserve would purchase mortgage-backed securities guaranteed by government-sponsored enterprises and GSE debt.

The People's Bank of **China** cut its main policy interest rate by 1.08 percentage points, to 5.58%. The reduction was the central bank's biggest for 11 years.

German business confidence plunged to its lowest for 15 years in November, according to a monthly index published by Ifo, a Munich research institute. However, the number of unemployed people fell, and by more than expected, that month. The jobless rate remained at 7.5%. Germany's inflation rate dropped sharply in the same month, to 1.4%, from 2.4% in October.

Britain's nominal GDP rose by only 3% in the year to the third quarter, the slowest for almost 50 years. The weak reading increased the chances of a big cut in interest rates in early December.

Poland's central bank lowered its benchmark interest rate from 6% to 5.75%, the first reduction since February 2006.



Output, prices and jobs

Nov 27th 2008
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2008†	2009†	latest	latest	year ago	2008†	rate‡, %
United States	+0.7 Q3	-0.5	+1.4	-0.2	-4.1 Oct	+3.7 Oct	+3.5	+4.3	6.5 Oct
Japan	-0.1 Q3	-0.4	+0.5	-0.1	+0.2 Sep	+2.1 Sep	-0.2	+1.7	4.0 Sep
China	+9.0 Q3	na	+9.6	+8.0	+8.2 Oct	+4.0 Oct	+6.5	+6.4	9.2 2007
Britain	+0.3 Q3	-2.0	+0.9	-1.0	-2.2 Sep	+4.5 Oct§	+2.1	+3.8	5.8 Sep††
Canada	+0.7 Q2	+0.3	+0.6	+0.5	-3.3 Aug	+2.6 Oct	+2.4	+2.8	6.2 Oct
Euro area	+0.7 Q3	-0.8	+1.1	-0.1	-2.4 Sep	+3.2 Oct	+2.6	+3.3	7.5 Sep
Austria	+1.5 Q3	+0.4	+2.0	+0.8	-0.5 Sep	+3.1 Oct	+2.8	+2.9	3.2 Sep
Belgium	+1.2 Q3	+0.4	+1.4	+0.3	-5.0 Aug	+4.7 Oct	+2.2	+4.6	10.9 Sep‡‡
France	+0.6 Q3	+0.6	+0.9	nil	-1.9 Sep	+2.7 Oct	+2.0	+3.2	7.9 Sep
Germany	+0.8 Q3	-2.1	+1.4	-0.2	-2.3 Sep	+1.4 Nov	+3.2	+2.8	7.5 Nov
Greece	+3.1 Q3	+2.0	+2.6	+1.4	-3.3 Sep	+3.9 Oct	+3.1	+4.4	7.1 Aug
Italy	-0.9 Q3	-2.0	-0.1	-0.4	-5.7 Sep	+3.5 Oct	+2.1	+3.5	6.8 Q2
Netherlands	+1.8 Q3	+0.1	+2.1	+0.5	-1.6 Sep	+2.8 Oct	+1.6	+2.5	3.8 Oct††
Spain	+0.9 Q3	-0.9	+1.3	-0.5	-4.5 Sep	+3.6 Oct	+3.6	+4.5	11.9 Sep
Czech Republic	+4.7 Q3	+6.1	+4.1	+3.4	+3.4 Sep	+6.0 Oct	+4.0	+6.7	5.2 Oct
Denmark	+0.9 Q2	+1.6	+0.2	nil	+0.1 Sep	+3.7 Oct	+1.7	+3.5	1.7 Oct
Hungary	+0.8 Q3	-0.4	+2.0	+3.0	-0.7 Sep	+5.1 Oct	+6.7	+6.7	7.7 Oct††
Norway	+0.6 Q3	-2.8	+2.5	+1.5	-4.2 Sep	+5.5 Oct	-0.2	+3.6	2.5 Sep***
Poland	+5.8 Q2	na	+5.1	+2.9	+0.2 Oct	+4.2 Oct	+3.0	+4.3	8.8 Oct‡‡
Russia	+7.8 Q2	na	+7.0	+3.7	+0.6 Oct	+14.2 Oct	+10.8	+14.0	6.1 Oct‡‡
Sweden	+0.7 Q2	-0.1	+1.1	+0.5	-4.9 Sep	+4.0 Oct	+2.7	+3.7	5.7 Oct‡‡
Switzerland	+2.4 Q2	+1.5	+1.9	+0.4	+6.1 Q2	+2.6 Oct	+1.3	+2.6	2.6 Oct
Turkey	+1.9 Q2	na	+3.0	+1.7	-5.5 Sep	+12.0 Oct	+7.0	+10.2	9.0 Q3‡‡
Australia	+2.7 Q2	+1.1	+2.6	+1.9	+2.8 Q2	+5.0 Q3	+1.9	+4.4	4.3 Oct
Hong Kong	+1.7 Q3	-2.0	+3.8	+0.5	-4.2 Q2	+1.8 Oct	+3.2	+4.5	3.5 Oct††
India	+7.9 Q2	na	+6.3	+6.1	+4.8 Sep	+9.8 Sep	+6.4	+7.8	7.2 2007
Indonesia	+6.1 Q3	na	+6.2	+3.5	-0.9 Sep	+11.8 Oct	+5.8	+10.5	8.5 Feb
Malaysia	+6.3 Q2	na	+5.6	+3.2	-1.7 Sep	+7.6 Oct	+1.9	+5.8	3.5 Q2
Pakistan	+5.8 2008**	na	+6.0	+2.9	-5.6 Aug	+25.0 Oct	+9.3	+20.8	5.6 2007
Singapore	-0.6 Q3	-6.8	+2.0	-0.1	-12.6 Oct	+6.4 Oct	+3.6	+6.6	2.2 Q3
South Korea	+3.9 Q3	+2.3	+4.5	+1.6	+6.1 Sep	+4.8 Oct	+3.0	+5.0	3.1 Oct
Taiwan	-1.0 Q3	na	+4.0	+1.5	-12.5 Oct	+2.4 Oct	+5.3	+3.8	4.3 Oct
Thailand	+4.0 Q3	+2.3	+4.5	+3.1	+4.6 Sep	+3.9 Oct	+2.5	+5.8	1.3 Jul
Argentina	+7.8 Q2	+8.7	+6.2	+2.2	+4.4 Sep	+8.4 Oct	+8.4	+9.0	7.8 Q3‡‡
Brazil	+6.1 Q2	+6.6	+5.3	+2.7	+9.8 Sep	+6.4 Oct	+4.1	+5.8	7.5 Oct‡‡
Chile	+4.8 Q3	-0.2	+3.9	+2.8	+3.2 Sep	+9.9 Oct	+6.5	+8.8	7.8 Sep††‡‡
Colombia	+3.7 Q2	+2.8	+4.5	+4.0	-3.3 Sep	+7.9 Oct	+5.2	+6.7	11.1 Sep‡‡
Mexico	+1.6 Q3	+2.6	+1.9	+0.9	-1.9 Sep	+5.8 Oct	+3.7	+5.3	4.1 Oct‡‡
Venezuela	+4.6 Q3	na	+5.4	+2.7	-6.8 Aug	+35.6 Oct	+17.2	+31.0	7.2 Q3‡‡
Egypt	+6.8 Q2	na	+7.1	+6.7	+6.8 Q2	+20.2 Oct	+7.5	+17.1	8.4 Q2‡‡
Israel	+5.1 Q3	+2.3	+4.1	+2.5	+3.0 Sep	+5.5 Oct	+2.2	+4.7	5.9 Q3
Saudi Arabia	+3.5 2007	na	+6.5	+3.3	na	+10.4 Sep	+4.9	+8.5	na
South Africa	+2.9 Q3	+0.2	+3.5	+2.5	+4.9 Sep	+12.1 Oct	+7.9	+11.3	23.2 Sep‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	-3.3 Q3	na	-1.5	-1.1	-3.8 Sep	+9.8 Oct	+8.5	+10.5	4.2 Sep
Finland	+2.4 Q2	+3.1	+2.6	+1.1	+0.8 Sep	+4.4 Oct	+2.6	+4.2	6.0 Oct
Iceland	+5.0 Q2	+20.9	nil	+0.8	+0.4 2007	+17.1 Nov	+5.2	+12.0	1.9 Oct‡‡
Ireland	-0.8 Q2	-2.1	-2.4	-1.9	+4.0 Sep	+4.0 Oct	+4.8	+4.0	6.7 Oct
Latvia	-4.2 Q3	na	-0.4	-0.5	-5.4 Sep	+13.8 Oct	+13.2	+15.8	6.8 Sep
Lithuania	+3.1 Q3	+1.6	+4.4	+1.6	na	+10.5 Oct	+7.5	+11.0	4.7 Aug‡‡
Luxembourg	+2.8 Q2	+4.5	+2.5	+1.5	-0.7 Sep	+3.3 Oct	+2.9	+4.0	4.3 Sep‡‡
New Zealand	-0.3 Q2	-2.1	+0.3	+1.1	+2.4 Q2	+5.1 Q3	+1.8	+4.3	4.2 Q3
Peru	+9.9 Sep	na	+9.1	+5.5	+9.0 Sep	+6.5 Oct	+3.1	+5.7	7.7 Sep††
Philippines	+4.6 Q3	+3.4	+4.4	+2.3	+6.5 Aug	+11.2 Oct	+2.7	+9.6	7.4 Q3‡‡
Portugal	+0.7 Q3	nil	+0.4	-0.8	-4.3 Sep	+2.3 Oct	+2.6	+2.9	7.7 Q3‡‡
Slovakia	+7.1 Q3	nil	+6.8	+4.5	+5.5 Sep	+5.1 Oct	+3.2	+4.7	7.5 Oct††
Slovenia	+5.5 Q2	na	+4.2	+2.8	+5.6 Sep	+4.9 Oct	+5.1	+6.0	6.3 Sep‡‡

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions.- §RPI inflation rate 4.2% in Oct. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. ***Centred 3-month average

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Nov 27th 2008
From The Economist print edition

The Economist commodity-price index

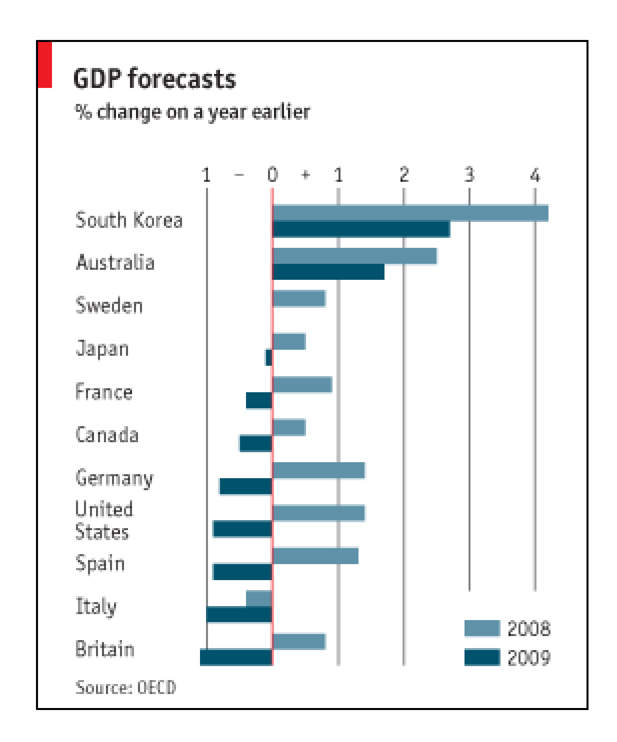
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	Nov 18th	Nov 25th*	% change on one month	% change on one year
Dollar index				
All items	160.4	157.3	-8.7	-25.9
Food	177.1	175.2	-4.7	-13.2
Industrials				
All	138.9	134.2	-14.8	-40.5
Nfa†	127.3	117.6	-15.8	-33.3
Metals	145.3	143.2	-14.3	-43.3
Sterling index				
All items	162.1	156.0	+1.2	+0.3
Euro index				
All items	117.3	112.0	-7.3	-15.2
Gold				
$ per oz	738.25	810.50	+4.8	-0.3
West Texas Intermediate				
$ per barrel	54.37	50.93	-28.3	-46.1

*Provisional †Non-food agriculturals.

GDP forecasts

Nov 27th 2008
From The Economist print edition



Output will decline in most OECD countries next year, according to gloomy forecasts released by the intergovernmental think-tank on November 25th. America's GDP will fall by 0.9% in 2009. Although the OECD thinks it will then grow by 1.6% in 2010, helped by aggressive loosening in monetary policy, it gives warning that the recovery may be imperilled in a prolonged credit crunch. The euro area's GDP will decline by 0.6 % in 2009 and climb by 1.2% in 2010. A brief growth spurt is expected in Japan in early 2009 thanks to a fiscal stimulus, but output is set to stagnate over the second half of the year. The number of unemployed people in OECD countries could rise by as much as 8m over the next two years.

Trade, exchange rates, budget balances and interest rates

Nov 27th 2008
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2008†	Currency units, per $ Nov 26th	Currency units, per $ year ago	Budget balance % of GDP 2008†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−851.1 Sep	−699.0 Q2	−4.6	–	–	−3.2	1.28	2.96
Japan	+64.8 Sep	+185.9 Sep	+4.0	95.0	110	−3.0	0.77	1.39
China	+265.2 Oct	+371.8 2007	+8.9	6.83	7.39	0.4	3.47	3.20
Britain	−185.5 Sep	−82.9 Q2	−3.0	0.65	0.48	−3.8	3.90	3.78
Canada	+52.6 Sep	+13.6 Q2	+0.9	1.23	0.99	0.2	1.86	3.57
Euro area	−40.4 Sep	−51.4 Sep	−0.4	0.78	0.68	−1.1	3.90	3.27
Austria	−0.3 Aug	+14.5 Q2	+2.9	0.78	0.68	−1.0	3.90	3.88
Belgium	+10.2 Aug	−9.8 Jun	+1.6	0.78	0.68	−0.6	3.96	3.99
France	−80.7 Sep	−53.6 Sep	−1.7	0.78	0.68	−3.0	3.90	3.71
Germany	+288.4 Sep	+266.8 Sep	+6.7	0.78	0.68	0.9	3.90	3.27
Greece	−67.7 Sep	−52.5 Sep	−10.3	0.78	0.68	−3.2	3.90	4.86
Italy	−17.0 Sep	−70.8 Sep	−2.9	0.78	0.68	−2.6	3.90	4.40
Netherlands	+60.0 Sep	+62.5 Q2	+6.7	0.78	0.68	1.1	3.90	3.68
Spain	−154.9 Aug	−165.3 Aug	−10.0	0.78	0.68	−2.5	3.90	3.87
Czech Republic	+6.3 Sep	−5.0 Sep	−2.9	19.3	18.0	−2.0	4.09	4.08
Denmark	+6.5 Sep	+6.5 Sep	+1.2	5.78	5.05	4.1	6.75	3.86
Hungary	+0.4 Sep	−8.8 Q2	−5.5	203	172	−3.8	11.14	9.80
Norway	+83.8 Oct	+78.1 Q2	+17.3	7.01	5.48	17.8	5.80	4.01
Poland	−22.0 Sep	−27.3 Sep	−5.6	2.92	2.47	−1.8	6.63	5.98
Russia	+195.9 Sep	+116.5 Q3	+6.2	27.4	24.4	4.5	12.00	9.43
Sweden	+18.6 Oct	+38.6 Q2	+7.7	8.05	6.33	2.4	2.85	2.96
Switzerland	+17.7 Oct	+60.2 Q2	+12.0	1.20	1.12	0.9	1.29	2.17
Turkey	−75.6 Sep	−47.1 Sep	−7.1	1.58	1.19	−1.6	21.09	10.42‡
Australia	−14.0 Sep	−61.1 Q2	−5.4	1.54	1.13	0.3	4.48	4.62
Hong Kong	−27.2 Oct	+27.5 Q2	+10.3	7.76	7.79	−1.0	1.94	1.52
India	−106.5 Sep	−21.9 Q2	−3.2	49.5	39.8	−4.3	7.29	7.69
Indonesia	+17.3 Sep	+6.3 Q2	+0.5	12,075	9,418	−1.4	12.39	13.07‡
Malaysia	+41.9 Sep	+35.3 Q2	+12.8	3.62	3.38	−5.0	3.40	5.37‡
Pakistan	−22.4 Oct	−14.0 Q2	−6.2	78.8	61.1	−6.7	15.45	24.98‡
Singapore	+20.6 Oct	+29.2 Q3	+17.4	1.51	1.44	0.8	0.75	2.22
South Korea	−12.2 Oct	−8.3 Oct	−2.3	1,478	932	1.0	5.43	5.72
Taiwan	+6.5 Oct	+28.8 Q3	+5.8	33.3	32.3	−1.7	2.45	1.61
Thailand	+3.7 Sep	+5.4 Sep	−0.4	35.3	33.8	−1.9	3.85	3.56
Argentina	+14.2 Oct	+6.0 Q2	+2.7	3.35	3.15	0.7	19.75	na
Brazil	+26.5 Oct	−26.6 Oct	−1.8	2.32	1.80	−1.6	13.64	6.16‡
Chile	+14.4 Oct	−1.6 Q3	−1.0	661	511	7.0	8.04	4.35‡
Colombia	+2.3 Aug	−4.9 Q2	−2.6	2,314	2,066	−1.0	9.96	8.57‡
Mexico	−12.5 Oct	−11.8 Q3	−0.8	13.2	10.9	nil	7.82	9.20
Venezuela	+50.2 Q3	+49.4 Q3	+14.8	4.95	6.23§	1.6	17.00	6.55‡
Egypt	−23.4 Q2	+0.9 Q2	+0.2	5.52	5.53	−7.1	11.90	7.05‡
Israel	−14.1 Oct	+3.5 Q2	+0.9	3.85	3.87	−0.8	2.69	4.78
Saudi Arabia	+150.8 2007	+95.0 2007	+31.7	3.75	3.72	13.3	3.41	na
South Africa	−10.6 Sep	−22.5 Q2	−6.0	9.93	6.89	0.3	12.10	8.21
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−4.2 Sep	−3.3 Sep	−12.0	12.1	10.6	−0.7	7.05	na
Finland	+11.4 Sep	+10.0 Sep	+3.8	0.78	0.68	4.5	3.93	3.80
Iceland	−0.6 Oct	−4.5 Q2	−18.5	140	61.6	2.0	18.45	na
Ireland	+39.0 Aug	−15.8 Q2	−2.9	0.78	0.68	−5.8	3.90	4.19
Latvia	−6.4 Sep	−5.3 Sep	−15.0	0.55	0.47	−1.5	11.32	na
Lithuania	−7.9 Sep	−6.7 Sep	−13.9	2.68	2.34	−0.9	8.13	na
Luxembourg	−6.9 Aug	+5.1 Q2	na	0.78	0.68	0.3	3.90	na
New Zealand	−3.7 Oct	−11.4 Q2	−7.1	1.82	1.30	0.3	6.15	5.32
Peru	+5.5 Sep	−1.5 Q2	−2.8	3.10	3.00	2.7	6.61	na
Philippines	−8.6 Sep	+4.3 Jun	+1.7	49.1	42.9	−0.9	5.00	na
Portugal	−33.6 Aug	−28.7 Sep	−9.7	0.78	0.68	−2.4	3.90	4.01
Slovakia	−0.8 Sep	−6.1 Jul	−5.6	23.6	22.6	−2.2	1.55	4.33
Slovenia	−4.6 Sep	−3.5 Aug	−6.6	0.78	0.68	0.4	3.90	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.
Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.



Markets

Nov 27th 2008
From The Economist print edition

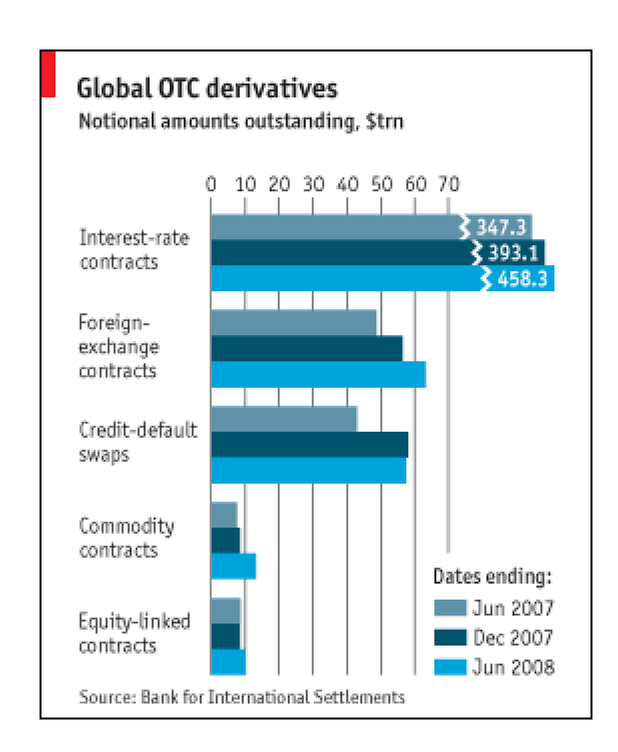
Markets

		% change on	Dec 31st 2007	
	Index Nov 26th	one week	in local currency	in $ terms
United States (DJIA)	8,726.6	+9.1	−34.2	−34.2
United States (S&P 500)	887.7	+10.1	−39.5	−39.5
United States (NAScomp)	1,532.1	+10.5	−42.2	−42.2
Japan (Nikkei 225)	8,213.2	−0.7	−46.3	−36.9
Japan (Topix)	817.2	−1.2	−44.6	−34.9
China (SSEA)	1,993.3	−5.9	−63.9	−61.4
China (SSEB, $ terms)	106.6	−1.4	−72.8	−70.9
Britain (FTSE 100)	4,152.7	+3.7	−35.7	−50.2
Canada (S&P TSX)	8,643.5	+1.8	−37.5	−49.9
Euro area (FTSE Euro 100)	720.7	+3.1	−47.6	−53.8
Euro area (DJ STOXX 50)	2,373.8	+3.4	−46.0	−52.4
Austria (ATX)	1,754.9	+6.6	−61.1	−65.7
Belgium (Bel 20)	1,809.3	−7.0	−56.2	−61.3
France (CAC 40)	3,169.9	+2.7	−43.5	−50.2
Germany (DAX)*	4,560.5	+4.7	−43.5	−50.2
Greece (Athex Comp)	1,873.6	−1.2	−63.8	−68.1
Italy (S&P/MIB)	19,901.0	+1.9	−48.4	−54.5
Netherlands (AEX)	245.2	+3.0	−52.5	−58.1
Spain (Madrid SE)	924.8	+5.2	−43.7	−50.3
Czech Republic (PX)	817.3	+5.2	−55.0	−57.7
Denmark (OMXCB)	230.3	−0.4	−48.7	−54.7
Hungary (BUX)	11,925.0	+3.5	−54.5	−61.2
Norway (OSEAX)	259.8	+7.5	−54.4	−64.7
Poland (WIG)	27,246.4	+4.4	−51.0	−58.8
Russia (RTS, $ terms)	658.6	+8.7	−67.9	−71.2
Sweden (Aff.Gen)	187.7	+4.9	−44.9	−55.7
Switzerland (SMI)	5,498.6	−0.5	−35.2	−38.9
Turkey (ISE)	24,408.6	+11.3	−56.1	−67.4
Australia (All Ord.)	3,479.6	−0.1	−45.8	−59.8
Hong Kong (Hang Seng)	13,369.5	+4.3	−51.9	−51.7
India (BSE)	9,026.7	+2.9	−55.5	−64.6
Indonesia (JSX)	1,193.2	+1.1	−56.5	−66.2
Malaysia (KLSE)	856.4	−2.4	−40.7	−45.9
Pakistan (KSE)	9,187.1	nil	−34.7	−48.9
Singapore (STI)	1,711.1	+2.7	−50.6	−53.0
South Korea (KOSPI)	1,029.8	+1.3	−45.7	−65.6
Taiwan (TWI)	4,271.8	−0.3	−49.8	−51.1
Thailand (SET)	395.2	−3.3	−53.9	−56.0
Argentina (MERV)	954.8	+3.2	−55.6	−58.2
Brazil (BVSP)	36,469.0	+9.2	−42.9	−56.2
Chile (IGPA)	11,540.4	−2.4	−18.0	−38.3
Colombia (IGBC)	7,230.0	+3.1	−32.4	−41.1
Mexico (IPC)	20,025.8	+7.8	−32.2	−44.1
Venezuela (IBC)	34,571.9	−2.3	−8.8	−60.4
Egypt (Case 30)	3,978.7	−2.9	−62.0	−62.0
Israel (TA-100)	565.4	−3.4	−51.0	−51.1
Saudi Arabia (Tadawul)	4,424.2	−9.3	−59.9	−59.9
South Africa (JSE AS)	20,474.7	+9.2	−29.3	−51.3
Europe (FTSEurofirst 300)	830.6	+2.3	−44.9	−51.4
World, dev'd (MSCI)	876.9	+6.7	−44.8	−44.8
Emerging markets (MSCI)	513.3	+4.8	−58.8	−58.8
World, all (MSCI)	215.9	+6.5	−46.5	−46.5
World bonds (Citigroup)	761.2	+2.6	+4.2	+4.2
EMBI+ (JPMorgan)	359.3	+3.6	−17.1	−17.1
Hedge funds (HFRX)	1,043.4	+0.3	−21.5	−21.5
Volatility, US (VIX)	54.9	74.3	22.5	(levels)
CDSs, Eur (iTRAXX)†	163.6	−5.7	+223.3	+185.1
CDSs, N Am (CDX)†	255.5	+1.7	+228.0	+228.0
Carbon trading (EU ETS) €	15.7	−4.5	−29.5	−37.8

*Total return index. †Credit-default swap spreads, basis points.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac.

Global OTC derivatives

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The notional amounts of over-the-counter derivatives continued to expand in the first half of 2008, according to data from the Bank for International Settlements (BIS). They reached $684 trillion at the end of June, 15% higher than in December 2007. Interest-rate contracts, which account for the lion's share of the market, expanded by 17%. But credit-default swaps (CDSs) declined slightly over the same period, to $57.3 trillion, the first fall since figures for CDSs started to be published in December 2004. Gross market values, which measure the cost of replacing all existing contracts, went up by 29% to $20.4 trillion at the end of June. The BIS says these are a better gauge of market risk than notional amounts.